

Docketed:
April 4, 1997Court: United States Court of Appeals for
the Fifth Circuit

Entry Date

Proceedings and Orders

Entry Date	Proceedings and Orders
Apr 4 1997	Petition for writ of certiorari filed. (Response due May 4, 1997)
May 2 1997	Brief amicus curiae of American Bar Association filed.
May 2 1997	Brief amici curiae of Texas Interest on Lawyers Trust Accounts Program, et al. filed.
May 5 1997	Brief of respondents Washington Legal Foundation and William Summers in opposition filed.
May 5 1997	Brief amici curiae of Columbus Bar Association, et al. filed.
Jun 10 1997	DISTRIBUTED. June 26, 1997
Jun 11 1997	Reply brief of petitioners Thomas Phillips, et al. filed.
Jun 27 1997	Petition GRANTED. limited to Question 1 presented by the petition. SET FOR ARGUMENT January 13, 1998. *****
Jun 27 1997	The order granting the petition for a writ of certiorari is amended to read as follows: The petition for a writ of certiorari is granted limited to the following question: Is interest earned on client trust funds held by lawyers in IOLTA accounts a property interest of the client or lawyer, cognizable under the Fifth Amendment of the United States Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could not earn interest for the client or lawyer?
Jul 21 1997	Order extending time to file brief of petitioner on the merits until August 25, 1997.
Aug 20 1997	Brief amici curiae of Texas Equal Access to Justice Program, et al. filed.
Aug 22 1997	Brief amici curiae of American Association of Retired Persons, et al. filed.
Aug 25 1997	Brief of petitioners Thomas Phillips, et al. filed.
Aug 25 1997	Brief amicus curiae of Conference of Chief Justices filed.
Aug 25 1997	Brief amicus curiae of United States filed.
Aug 25 1997	Brief amicus curiae of American Bar Association filed.
Aug 25 1997	Joint appendix filed.
Aug 25 1997	Brief amici curiae of Columbus Bar Association, et al. filed.
Aug 25 1997	LODGING consisting of ten copies of two letters submitted by the Solicitor General
Aug 25 1997	Brief amici curiae of Massachusetts, et al. filed.
Aug 25 1997	Brief amici curiae of Council of State Governments, et al. filed.
Aug 25 1997	Motion of Massachusetts Bar Foundation for leave to file a brief as amicus curiae filed.
Aug 28 1997	Record filed.

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Entry	Date	Proceedings and Orders
Sep 5	1997	Record filed.
Sep 8	1997	Order extending time to file brief of respondent on the merits until October 10, 1997.
Oct 9	1997	Brief amicus curiae of National Right to Work Legal Defense Foundation filed.
Oct 9	1997	Brief amicus curiae of Pacific Legal Foundation filed.
Oct 10	1997	Brief of respondent Washington Legal Foundation and William Summers filed.
Oct 10	1997	Brief amici curiae of Defenders of Property Rights, et al. filed.
Oct 10	1997	Brief amicus curiae of Attorneys' Bar Association of Florida filed.
Oct 10	1997	Brief amici curiae of Robert Talton, et al. filed.
Oct 10	1997	Brief amicus curiae of Texas Justice Foundation filed.
Oct 10	1997	Brief amicus curiae of Mountain States Legal Foundation filed.
Oct 10	1997	Brief amicus curiae of Association for Objective Law filed.
Oct 14	1997	Motion of Massachusetts Bar Foundation for leave to file a brief as amicus curiae GRANTED.
Oct 24	1997	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
Oct 29	1997	Motion of respondents for divided argument filed.
Nov 3	1997	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
Nov 10	1997	Reply brief of petitioners Thomas P. Phillips, et al. filed.
Nov 17	1997	Motion of respondents for divided argument DENIED.
Nov 25	1997	CIRCULATED.
Jan 13	1998	ARGUED.
Jan 15	1998	Letter from counsel for the respondents received and distributed.

No. 96-961578 APR 4 1997

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ,
HON. JACK HIGHTOWER, HON. NATHAN L. HECHT,
HON. LLOYD DOGGETT, HON. JOHN CORNYN, HON.
BOB GAMMAGE, HON. CRAIG T. ENOCH, HON. ROSE
SPECTOR, TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION,
AND W. FRANK NEWTON, IN HIS OFFICIAL
CAPACITY AS CHAIRMAN OF THE TEXAS EQUAL ACCESS
TO JUSTICE FOUNDATION,

Petitioners,

v.

WASHINGTON LEGAL FOUNDATION,
WILLIAM R. SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

**Petition for Writ of Certiorari to the
United States Court of Appeals
for the Fifth Circuit**

PETITION FOR A WRIT OF CERTIORARI

NANCY TREASE
Office of the Attorney General
of Texas
P.O. Box 12548, Capitol Station
Austin, TX 78711
(512) 475-4075

Attorneys for Petitioners
Hon. Thomas R. Phillips,
Hon. Raul A. Gonzalez,
Hon. Jack Hightower,
Hon. Nathan L. Hecht,
Hon. Lloyd Doggett,
Hon. John Cornyn,
Hon. Bob Gammage,
Hon. Craig T. Enoch, and
Hon. Rose Spector

DARRELL E. JORDAN
H. ROBERT POWELL *
BRITTAN L. BUCHANAN
DAVID J. SCHENCK
HUGHES & LUCE, L.L.P.
111 Congress, Suite 900
Austin, Texas 78701
(512) 482-6800

Attorneys for Petitioners
Texas Equal Access to Justice
Foundation, and W. Frank
Newton, in His Official
Capacity as Chairman of the
Texas Equal Access to Justice
Foundation

April 4, 1997

* Counsel of Record

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QUESTIONS PRESENTED

Fifty States and the District of Columbia have adopted state law programs known as Interest on Lawyers' Trust Account programs ("IOLTA") to finance access to the legal system for the nation's economically disadvantaged. IOLTA provides financing by aggregating client trust funds that could not otherwise earn interest so that the interest on the combined funds can be utilized by non-profit organizations whose primary purpose is the direct provision of civil legal services to the poor. The questions presented by this petition are:

1. Is interest earned on client trust funds held by lawyers in IOLTA accounts a property interest of the client or lawyer, cognizable under the First or Fifth Amendments to the U.S. Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could not earn interest for the client or the lawyer—a question on which courts of appeals are in conflict?
2. Is there a federal general common law on which a U.S. Court of Appeals may rest a determination whether interest earned on client trust funds held by lawyers in IOLTA accounts is a property interest cognizable under the First or Fifth Amendments to the U.S. Constitution, rather than following principles of comity and federalism that require deference to determinations of the issue by the highest appellate court of the State?

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ,
HON. JACK HIGHTOWER, HON. NATHAN L. HECHT,
HON. LLOYD DOGGETT, HON. JOHN CORNYN, HON.
BOB GAMMAGE, HON. CRAIG T. ENOCH, HON. ROSE
SPECTOR, TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION,
AND W. FRANK NEWTON, IN HIS OFFICIAL
CAPACITY AS CHAIRMAN OF THE TEXAS EQUAL ACCESS
TO JUSTICE FOUNDATION,

Petitioners,

v.

WASHINGTON LEGAL FOUNDATION,
WILLIAM R. SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

Petition for Writ of Certiorari to the
United States Court of Appeals
for the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

The Petitioners, the individual Justices of the Texas Supreme Court, the Texas Equal Access to Justice Foundation, and W. Frank Newton, in his official capacity as Chairman of the Texas Equal Access to Justice Foundation, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on September 12, 1996.

OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 94 F.3d 996 and is reprinted in the Appendix hereto. (App. A). The decision of the District Court is reported at 873 F. Supp. 1 and is also reprinted in the Appendix hereto. (App. B). The order denying Petitioner's request for panel rehearing and the dissenting opinion from the denial of rehearing *en banc* are reported at 106 F.3d 640 and are also reprinted in the Appendix. (App. C).

JURISDICTION

The judgment of the court of appeals was entered on September 12, 1996. Petitioners timely filed a request for panel rehearing and simultaneously requested rehearing from the Fifth Circuit *en banc*. The Petition for Panel Rehearing was denied on February 14, 1997. The Suggestion for Rehearing *En Banc* was denied, with six judges dissenting, on the same day. This Court's certiorari jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND REGULATORY PROVISIONS INVOLVED

The First and Fifth Amendments to the United States Constitution and a relevant federal statute are reprinted in the Appendix hereto. (App. D). Selected orders and regulations promulgated by the Texas Supreme Court are also reprinted in the Appendix. (App. E-G).

STATEMENT OF THE CASE

This petition seeks a resolution of the conflict among decisions of U.S. Courts of Appeals created by the decision of the court of appeals below which held that interest earned on IOLTA accounts is a constitutionally cognizable property interest of Respondents despite the inability of the funds in the accounts to earn interest otherwise. The petition is also concerned with whether the court of appeals below failed to give due deference to state law.

Texas is one of fifty states¹ and the District of Columbia to adopt IOLTA programs. Approximately 130,000 people receive legal services each year in Texas as a result, in part, of the financial resources made available by Texas' IOLTA program. Nationally, the number of people receiving legal services each year funded, in part, by IOLTA programs is 1,700,000. The IOLTA programs generate interest on otherwise unproductive nominal or short-term client funds maintained in attorney trust accounts in financial institutions, and distribute the interest earned on such funds to non-profit organizations whose primary purpose is the direct provision of civil legal services to the economically disadvantaged.

The fundamental precept of these programs is that client funds are not eligible for deposit into an IOLTA account if there is any reasonable expectation that interest can otherwise be earned on these funds for the client. The combination of attorneys' ethical obligations with respect to management of client funds, the economics of operating an interest-bearing demand account, and federal banking regulations prevent clients or lawyers from earning interest on nominal or short-term deposits. A client whose funds are placed in an IOLTA account has no less money, or earning power, or resources, because the money was placed in an IOLTA account. The client's balance sheet does not change according to whether IOLTA-eligible funds are placed in an IOLTA account or a non-IOLTA account.

Although the lawyers or their clients can never expect to earn interest on the funds, the aggregation of the same funds by virtue of an IOLTA program, without the cost of attributing interest to individual clients, can earn interest benefiting IOLTA. The Texas IOLTA Program, like other IOLTA programs, operates on the premise that nominal sums of money, or short-term deposits, held by attorneys on behalf of their clients, constitute an

¹ The Indiana Supreme Court has approved in principle the adoption of an IOLTA program, but the program is not yet operational.

unused economic resource which may be rendered productive by the aggregation of such funds by IOLTA to finance the delivery of legal services to low income persons. Prior to IOLTA, the economic advantage now provided by the aggregation of IOLTA-eligible client funds was available only to the financial institutions which held the funds.

The Washington Legal Foundation mounts, and continues to mount, constitutional attacks upon IOLTA programs across the nation by urging that the interest that can be earned on IOLTA funds constitutes constitutionally cognizable property interests. The case below was one of those attacks.

A. The District Court Proceedings.

Respondents² filed their lawsuit in the District Court alleging the Texas IOLTA Program constitutes an impermissible taking under the Fifth Amendment and interferes with their First Amendment rights, basing both claims on an alleged property interest in the actual interest generated in IOLTA accounts and a property right to exclude others from the beneficial use of their funds while deposited in IOLTA accounts. Respondents named as defendants each Justice of the Texas Supreme Court, the Texas Equal Access to Justice Foundation (the "Foundation" is the non-profit organization created by Order of the Texas Supreme Court to operate the Texas IOLTA Program), and W. Frank Newton, in his capacity as Chairman of the Foundation.

In its January 19, 1995 reported Memorandum Order and Judgment, the District Court granted summary judgment for Petitioners on the basis that Respondents have

² The Respondents are Michael Mazzone, a Texas resident and attorney licensed to practice by the State Bar of Texas; William Summers, a Texas resident and client with funds deposited in an IOLTA account; and the Washington Legal Foundation whose membership purports to include individuals with similar interests to Messrs. Mazzone and Summers.

no constitutionally cognizable property interest at stake, because, but for the IOLTA program, no interest could be earned on the funds in the IOLTA accounts. 873 F. Supp. at 7; Pet. App. p. 30. In so holding, the District Court had more than ample precedent, for it followed the logic of *Washington Legal Found. v. Mass. Bar Found.*, 993 F.2d 962 (1st Cir. 1993) and *Cone v. State Bar of Florida*, 819 F.2d 1002 (11th Cir.), cert. denied, 484 U.S. 917 (1987). The District Court also noted that its holding was consistent with decisions by the highest appellate courts of seven states that have addressed the issue.³ Pet. App. pp. 33-34.

B. The Decision of the Court of Appeals.

When it handed down its reported decision on September 12, 1996, the Fifth Circuit departed from the holdings of its sister circuits and other courts that have analyzed the IOLTA process against constitutional standards. 94 F.3d 996; Pet. App. p. 1. The Fifth Circuit cited the generic rule of state law that "interest follows principal" and relied on this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) to find that a property right existed in the actual interest generated in an IOLTA account. 94 F.3d at 1002; Pet. App. p. 12. The Fifth Circuit reached the conclusion that such

³ *Petition by Mass. Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985); *In re Adoption of Amendments to C.P.R.D.R. 9-102 IOLTA*, 102 Wash.2d 1101 (Wash. 1984); *In re Interest on Lawyers' Trust Accounts*, 279 Ark. 84, 648 S.W.2d 480 (1983); *In re Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *In re New Hampshire Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258 (1982); *In re Minnesota State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981); see also *Carroll v. State Bar of Cal.*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (Cal. Ct. App. 1984), cert. denied sub nom., *Chapman v. State Bar of California*, 474 U.S. 848 (1985) (intermediate California appellate court upheld IOLTA against constitutional challenge).

a property right was cognizable under the Constitution even though Respondents could not actually receive interest income on the nominal or short-term client trust funds tendered to attorneys under any set of circumstances. 94 F.3d at 1002-1003; Pet. App. pp. 12-13. The Fifth Circuit did not discuss the Texas Supreme Court's finding that on client funds eligible for deposit in an IOLTA account, interest income cannot reasonably be earned to benefit individual clients for whom the funds are held. Pet. App. p. 56.

Petitioners promptly filed a Petition for Panel Rehearing and a Suggestion for Rehearing *En Banc*. Both Petitions remained pending before the court of appeals for over four months, but were eventually denied on February 14, 1997 in a reported Order, over the dissent of six members of the court. 106 F.3d 640; Pet. App. p. 41.

A judgment of this Court reversing the Fifth Circuit's decision will result in a final judgment upholding the constitutionality of the IOLTA program, keeping the door open to justice for all.

REASONS FOR GRANTING THE WRIT

The public is debating whether justice is truly "for all" or only those who can afford the price of admission. That debate is fueled not only by a greater public awareness of the legal system at work brought on by the recent tendency to televise high publicity trials, but, also, by the growing belief that the legal system should make itself more accessible to the legal needs of our citizens regardless of their financial status. Long before the current clamor was heard, though, the state bodies regulating the legal profession adopted programs to finance legal services to low income persons without imposing a tax, assessing a fee or subjecting costs upon anyone. These were the IOLTA programs adopted by all fifty states and the District of Columbia. IOLTA has helped over a million people

across the nation obtain civil legal services. Attorneys maintained client trust accounts long before IOLTA programs were instituted. Commencement of these programs did not alter pre-IOLTA expectations of lawyers or clients with regard to the ability to earn interest on lawyers' client trust accounts. IOLTA programs are a superb example of government innovation *at the state level* providing an important public benefit largely through the private sector with absolutely no economic sacrifice by clients, by the public or by lawyers. There can be no doubt that the nation has a significant population of economically disadvantaged persons who cannot afford basic access to the legal system on their own. Nor can there be any doubt of the importance to those who, with pride, describe our body politic as a nation of laws, that this basic access be unencumbered by the barrier of economic disadvantage. A right sought to be protected through the legal system may be unpopular to some, but the right to access the legal system for its protection is important to all. Unfortunately, the financing of such access by IOLTA is under attack. Because of the opinion below, the attack will spread.

I. THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE CIRCUITS OVER WHETHER THE INTEREST GENERATED BY IOLTA PROGRAMS IS A PROPERTY INTEREST BECAUSE THE RESULTING UNCERTAINTY CALLS INTO QUESTION IMPORTANT PROGRAMS ADOPTED IN ALL FIFTY STATES AND THE DISTRICT OF COLUMBIA

The keystone of IOLTA is that a client's funds are not eligible for deposit into an IOLTA account if there is any reasonable expectation that interest can be earned on these funds for the client. Some client funds are not capable of earning interest outside of an IOLTA account. Any one client's funds may be too small in amount, or deposited for too short a time, to earn interest that can

be attributed to the client. However, aggregated under the auspices of IOLTA *without the cost of attribution* of the interest to specific clients, the same funds are able to generate interest where none could exist otherwise. The interest earned on an IOLTA account is the fruit of the aggregation, under the IOLTA Rules, of a client's funds with other clients' funds.

Indeed, Respondent Summers admitted that his attorney told him that his retainer deposited in an IOLTA account was most likely not capable of yielding interest in excess of the costs of establishing and maintaining a separate interest-bearing account. (R. Vol. 5, p. 770.) Despite the fact that Respondent Summers lost no interest income, Respondents attack IOLTA programs arguing that the interest that can be earned in IOLTA accounts constitutes a constitutionally cognizable property interest. The Fifth Circuit's decision below fractured IOLTA's key-stone by acceding to that argument and created a conflict on that precise issue with two other U.S. Courts of Appeals.

A. Fifty States And The District Of Columbia Adopted IOLTA Programs To Provide Access To The Legal System Largely Through The Private Sector.

The creation of the Texas IOLTA Program did nothing to change the pre-IOLTA economic expectations of clients with respect to nominal or short-term funds tendered to their lawyers. Historically, such client funds shared three characteristics. First, deposits were aggregated into "trust accounts" held by attorneys in their law firms' names, rather than being deposited on an individual client basis. (R. Vol. 3, pp. 419.) Second, clients did not earn interest income on the funds deposited with their attorneys because rules of professional conduct required that client funds be delivered *on demand* at the client's direction and banks did not pay interest on demand accounts. (R. Vol. 3, pp. 419.) Finally, rules of professional conduct prohibited attorneys from benefiting in any way from their

clients' trust accounts. (R. Vol. 3, pp. 419.) The Texas Rules of Professional Responsibility mirrored these three universal principles. State Bar Rules, art. XII, § 8, DR 9-102 (Texas Code of Professional Responsibility) (1982); Pet. App. pp. 60-61. Accordingly, neither lawyers nor their clients traditionally received interest income from the deposit of clients' funds in a bank.

Under the current rules, Texas lawyers must still place client funds in trust accounts, cannot pool clients' funds in order to benefit themselves from the interest earned,⁴ and must maintain client funds in such a fashion that they can be delivered at the client's direction on demand. TEX. DISCIPLINARY R. PROF. CONDUCT 1.14, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G (Vernon Supp. 1997) (State Bar Rules, art. X, § 9; Pet. App. pp. 59-60. Absent IOLTA, any benefit from client funds incapable of yielding net interest to the individual client accrues, by default, only to the depository financial institutions who are able to use the funds without paying interest to anyone.⁵ (R. Vol. 3, pp. 419-420.)

IOLTA was made possible by the federal authorization of NOW accounts. Until the advent of Negotiable Order of Withdrawal ("NOW") accounts authorized by the 1980 amendments to federal banking regulations, lawyers were unable to deposit client funds in interest-bearing ac-

⁴ If an attorney "owned" the interest earned on client funds, that interest would be commingled in the account with the clients' principal as the interest accrues in the account until withdrawn.

⁵ Because money is fungible, the transaction between depositor and bank is not a bailment of the actual funds placed in the bank. Rather, the depositor becomes the bank's creditor and is entitled to withdraw funds in the amounts specified in their depository agreement. *See In re Nat Warren Contracting Co.*, 905 F.2d 716, 718 (4th Cir. 1990) (holding that bank acquires legal title to funds once deposited), and *United States v. Banco Cafetero Panama*, 797 F.2d 1154, 1158 (2d Cir. 1986) (recognizing that a bank is not a bailee of depositors' funds). Accordingly, the banks are free to pool deposits and obtain any consequent benefits.

counts for the benefit of their clients because interest-bearing demand accounts were not available. 12 U.S.C. § 1832. NOW accounts are basically interest-bearing checking accounts and are suitable for use as client trust accounts because the principal can be returned to the client on demand. (R. Vol. 3, p. 386.) NOW accounts may consist "... solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for ... charitable ... purposes and which is not operated for profit." 12 U.S.C. § 1832(a)(2).

Even with passage of the NOW regulations, lawyers receive trust funds from clients that are incapable of earning interest in a demand account. Not all clients are eligible depositors under the NOW regulations, because corporations and partnerships are not eligible for NOW accounts. Further, some client funds are either too small in amount, or, are to be held for too short a period of time to earn interest in a single demand account. Finally, even pooling all client funds in a single NOW account does not bestow interest-earning capability on all client accounts. For example, all participants in the pooled account must be eligible depositors under the NOW regulations (*i.e.*, not corporations or partnerships). Moreover, even if all participants in the pooled account are eligible depositors, the costs of subaccounting the funds to attribute the interest to each client may exceed the interest earned on each particular client's funds.

IOLTA overcomes these obstacles in several ways. First, funds from otherwise ineligible depositors, such as partnerships or corporations, can lawfully be pooled together in an IOLTA account, because all of the interest belongs to an eligible non-profit organization, such as the Texas Equal Access to Justice Foundation. (R. Vol. 3, p. 386.) Second, funds of individuals that could not yield net interest in a non-IOLTA pooled account can be pooled in an IOLTA account unburdened by the administrative costs of attribution to individual owner-clients.

The Internal Revenue Service ("IRS") attributes the interest that then accrues in such an IOLTA account to the non-profit organization. Because such interest is not income to the client, the IRS does not tax the client. (R. Vol. 3, pp. 422-423.)

IOLTA programs do not require that clients deposit trust funds with their attorneys. That decision, just as it was before the commencement of IOLTA, remains with the discretion and agreement of the individual client and attorney. Moreover, IOLTA itself imposes no interference or restriction upon the client's use of, or access to the principal amount of the funds deposited in the trust account. The Texas IOLTA Program merely requires lawyers, choosing to accept client funds, to deposit the client funds in an IOLTA account when no account is available that will yield net interest to the client. IOLTA Rule 4; Pet. App. p. 57.

Under the Texas IOLTA Rules, when a client presents a lawyer funds to be placed in a trust account, the lawyer must make an initial determination whether such funds can be deposited into an account capable of returning net interest to that client. IOLTA Rule 6; Pet. App. pp. 57-58. If an account is available in which net interest can be earned by the client, the lawyer *must* deposit the client funds into that account. (R. Vol. 4, p. 529.) By definition, a client's moneys may not be placed in an IOLTA account if the moneys could earn interest for the client outside of the IOLTA account. The Texas IOLTA Rules do not impair an attorney's ability to establish interest-bearing accounts currently authorized by applicable banking laws to earn interest for clients. IOLTA Rule 6; Pet. App. pp. 57-58. As the District Court correctly concluded, "the only funds eligible for deposit in an IOLTA account are those that have no reasonable possibility of legally generating net interest income benefiting the client." 873 F. Supp. at 4; Pet. App. pp. 23-24. In determining the cost of maintaining the account, attorneys are directed to consider the bank's service charges and

the lawyer's accounting costs and tax reporting costs that would be incurred. IOLTA Rule 6; Pet. App. pp. 57-58. If the client funds deposited in an individual or pooled account *can* earn interest above and beyond such costs and charges, and, thus, earn a net return to the client in *any* amount, the funds may not be deposited into an IOLTA account.⁶ (R. Vol. 4, p. 529.) This includes funds deposited with a bank that offers subaccounting services. Nothing about the Texas IOLTA Program prohibits attorneys from employing subaccounting services or any other legal and ethically permissible means of maintaining client funds in such a manner that interest, net of expense, can accrue to the benefit of their clients.

B. The Fifth Circuit's Decision Has Created A Conflict Over Whether Interest Earned On Client Trust Funds Deposited in An IOLTA Account Is A Property Right Cognizable Under The Constitution Even Though The Owners Of Such Funds Could Not Reasonably Expect To Receive Such Interest.

The Fifth Circuit held that interest earned on IOLTA accounts is the property of the clients whose money is held in those accounts. This ruling conflicts with decisions in the First and Eleventh Circuits and the highest appellate courts of seven states. Moreover, the ruling was made without due regard for Texas law as discussed in Part II, *infra*. This conflict arises because the Fifth Circuit misinterpreted this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) to recognize a compensable property right in interest generated on deposited funds even when the owners of the funds could not reasonably expect actual receipt of the

⁶ To effect the placement of the funds in accordance with IOLTA Rule 4, the attorney instructs the depository institution to remit the interest earned, less the bank's reasonable service charges, to the Foundation. IOLTA Rule 9; Pet. App. p. 58. The IOLTA Funds are subsequently distributed by the Foundation in the form of grants to non-profit organizations whose use of IOLTA funds are assessed pursuant to ABA standards.

interest. *Webb's* does not stand for that proposition. The First and Eleventh Circuit courts and four of the seven state courts have correctly held that the rule in *Webb's* was limited to the deposit of funds under facts entirely distinct from the deposit of funds in an IOLTA program.⁷

Webb's involved a challenge to a Florida statute governing the management of funds interpleaded in the registry of a court. The statute authorized court clerks to deposit interpleaded funds in interest-bearing accounts, but also declared that any interest earned on such funds while deposited in the court should be deemed the property of the court. *Id.* at 156-157. Another statute authorized the court clerk to deduct an administrative fee for managing the funds while on deposit. *Id.* at 157. The appellant in *Webb's* had filed an interpleader action involving competing claims to \$1 million and deposited the funds at issue in the court registry. By the time the court released the funds for disbursement, the interest earned on the interpleaded fund exceeded \$100,000. *Id.* at 158. The court clerk retained the interest pursuant to the statute, and suit was brought challenging that action as a taking. The Florida Supreme Court held the statute constitutional, finding that there was no taking of private property because the interest earned on interpleaded funds by virtue of the state statute was public money. A direct appeal was taken to this Court.

This Court stated that *Webb's* presented the issue "whether it is constitutional for a county to take as its

⁷ While all seven state courts and a California appellate court held that interest on IOLTA accounts was not clients' property, the Supreme Courts of Arkansas, Minnesota and Utah so held without discussing *Webb's*. One state court intimated in *dicta* that IOLTA interest proceeds belong to clients. *In re Ind. State Bar Ass'n's Petition to Authorize a Program Governing Interest on Lawyers' Trust Accounts*, 550 N.E.2d 311, 312-315 (Ind. 1990). As mentioned *infra*, the Indiana Supreme Court has since approved in principle adoption of an IOLTA program, but the program is not yet operational.

own, under the authority of a state statute, the interest accruing on an interpleader fund deposited in the registry of the county court, when a fee, prescribed by another statute, is also charged for the clerk's services in receiving the fund into the registry." *Id.* at 155-156. Stating that the "usual and general rule" is that interest on an interpleaded and deposited fund follows the principal, this Court held that the interest on such funds was private property. *Id.* at 162-164. This Court held that "under the narrow circumstances of this case" the county's taking of interest in excess of a clerk's fee for services rendered violated the Fifth Amendment. *Id.* at 164-165. Accordingly, *Webb's* recognized a compensable property right *in net interest*.

Despite its limited holding, various litigants, including Respondents, have relied on *Webb's* to challenge IOLTA as appropriating property because of its recitation of the general rule that interest follows principal. The Fifth Circuit in this case agreed and held that *Webb's* created a rule "independent of the amount or value of interest at issue" and, therefore, Respondents had a property right to the interest that accrued in IOLTA accounts. 94 F.3d at 1002; Pet. App. p. 12.

Numerous courts analyzing the IOLTA process after *Webb's*, however, have held that IOLTA does not implicate constitutionally protected property rights. The analysis of the IOLTA process by the Eleventh Circuit in *Cone v. State Bar of Fla.*, 819 F.2d 1002 (11th Cir.), *cert. denied*, 484 U.S. 917 (1987) is exemplary of the decisions by the courts reaching a contrary conclusion from the Fifth Circuit. The court in *Cone* squarely addressed the issue whether the interest earned on nominal or short term funds held in an IOLTA account was the property of the client for the purposes of the Fifth Amendment under *Webb's*. *Cone*, 819 F.2d at 1004. The court held that the client had no constitutionally cognizable property interest, because she failed to show a claim of entitlement

to the interest based upon substantive law or mutually explicit understandings. The court agreed with the conclusion of the district court that such a claim of entitlement could not be shown because of the economics of running an interest-producing trust account and restrictions that federal banking law places upon NOW accounts. *Id.* at 1005. According to the court, the IOLTA program satisfies the NOW restrictions against corporations and partnerships having NOW accounts by making a nonprofit organization the sole recipient of interest. The court also noted that making one entity the recipient of the interest allowed funds to be aggregated without the need for accounting for the earnings on the funds of individual clients, thus allowing the interest earned to exceed bank charges. *Id.* at 1006. Given the practical, economic and regulatory impediments, the court concluded that a client simply had no legitimate expectation to receive interest on nominal or short term funds tendered to an attorney because such funds were not capable of earning interest for the client regardless of the nature of the account in which the lawyer might deposit the funds. *Id.* at 1006.

Noting a "superficial similarity" between the IOLTA process and the deposit of funds in *Webb's*, the court in *Cone* correctly held that the crucial distinction between *Webb's* and IOLTA was that the facts in *Webb's* led to a legitimate expectation of net interest exclusive of administrative costs and expenses. *Id.* at 1007. The court agreed with the district court that the funds deposited in an IOLTA account had no "net value" to the client, hence there was no property interest for the state to appropriate. *Id.* By combining all deposits with IOLTA as the sole beneficiary, "interest income had been created which was not within the legitimate expectation of the owner of any one of the principal amounts." *Id.* at 1007.

In *Washington Legal Found. v. Mass. Bar Found.*, 993 F.2d 962 (1st Cir. 1993), the First Circuit analyzed the process by which IOLTA generates interest and found,

in discussing the plaintiff's First Amendment claim, that the interest does not belong to clients because it is generated by "an anomaly created by the practicalities of accounting, banking practices, and ethical obligations of lawyers." *Mass. Bar Found.*, 993 F.2d at 980. Accordingly, the First Circuit held that "interest generated by funds deposited in IOLTA accounts is not the clients' money." *Id.* In discussing the Fifth Amendment taking claim, the First Circuit found that *Webb's* did not apply because it involved a "recognized property right to the interest earned while the funds were held in the county registries," and that plaintiffs had no such property right to the interest earned on their funds in IOLTA accounts.⁸ *Id.* at 975.

The District Court in the present case thoughtfully reviewed the IOLTA process and its context and held that no property interest was implicated to support Respondent's constitutional claims. 873 F. Supp. at 10; Pet. App. p. 37. It correctly distinguished *Webb's* and found that unlike the claimants to the interest earned by a \$1 million fund in *Webb's*, interest accrues in IOLTA accounts *only* when the owners of the fund have no reasonable expectation to earn interest income on the deposited funds elsewhere. 873 F. Supp. at 7; Pet. App. pp. 29-30.

The Fifth Circuit expressly held that the District Court and the opinions in *Cone* and *Mass. Bar Found.* were wrong, concluding that *Webb's* recognizes a property right to the interest the moment it accrues in the bank, regardless whether there is any expectation by the depositors to ever receive it. 94 F.3d at 1002-1003; Pet. App. pp. 12-13. This Court should grant the writ to resolve this conflict and confirm *Webb's* intended reach.

⁸ Moreover, the First Circuit further distinguished *Webb's* because the plaintiffs in that case, Respondent Washington Legal Foundation, did not claim a property right to the interest earned on IOLTA accounts but "eschewed a right to the interest itself." *Id.* at 973.

C. The Significance Of This Case Is Not Limited To The IOLTA Context But Raises Broader Questions Under The Fifth Amendment.

This Court's takings analysis is triggered only by a showing of a reasonable expectation of a property interest. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1019, n.8 (1992); *Penn Central Trans. Co. v. City of New York*, 438 U.S. 104, 124-125 (1978). Individuals are not entitled to constitutional protection of unilateral expectations or abstract claims. *Webb's*, 449 U.S. at 161.

The Fifth Circuit held, however, that clients have a property right to the interest earned in IOLTA accounts because the interest accrues in the bank before deduction of expenses. 94 F.3d at 1003; Pet. App. p. 13. Thus, the court held that a property right attaches to this "gross" interest because "interest follows principal" and remains attached to the interest even if completely offset by administrative expenses. This holding amounts to a finding that a compensable property right exists in the interest generated on a fund in all contexts regardless of the reasonable expectations of the owners of the fund.

In so holding, the Fifth Circuit failed to distinguish between the accrual of interest in the abstract, and the ability of money to earn interest proceeds to which the depositors were entitled. The holding disregards this Court's requirement that there must be a reasonable expectation of property given the economic factors present, in order for a claimed property right to rise to constitutional dimension. *Lucas*, 505 U.S. at 1019, n.8; *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972) (must have a legitimate claim of entitlement to be protectable property interest). Even *Webb's* reflected that "a mere unilateral expectation or abstract need is not a property interest entitled to protection." *Webb's*, 449 U.S. at 161. The costs of earning interest cannot be separated from the accrual of interest, for the reasonable expectation of the owner of the principal cannot be to disregard the necessary costs of earning the

interest. No reasonable person would consider that she could earn interest on funds if the costs of doing so would exceed the expected interest to be earned. To exclude such costs from consideration would ignore economic reality and require one to engage in the kind of "abstract" property theory decried by this Court. *Id.*

The Fifth Circuit also failed to consider the high degree to which personal property in general, or interest on bank deposits in particular,⁹ is subject to regulation and control by the sovereign. These kinds of regulation define personal property owners' reasonable expectations. As the Court explained in *Lucas*, "in the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulation might even render his property economically worthless." *Lucas*, 505 U.S. at 1027-1028. Incidental burdens on the prospective use of personal property are "borne to secure 'the advantage of living and doing business in a civilized community'" and thus are not regarded as a "taking" requiring compensation. *Andrus v. Allard*, 444 U.S. 51, 67 (1979) (quoting *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 422 (1922) (Brandeis, J., dissenting)). As set forth above, client trust fund regulations in place well before the inception of IOLTA prevented lawyers or clients from expecting to earn interest on nominal or short-term funds. IOLTA merely shifts the benefit of interest accrual from financial institutions to a non-profit organization. The creation of NOW accounts did not lead clients to expect they would receive interest income on such accounts regardless of the amount deposited. In fact, IOLTA funds are defined by the lack of such expectation. Yet,

⁹ For example, financial transactions have traditionally been subject to state regulation. While most states impose an income tax on interest, e.g., Jerome R. Hellerstein & Walter Hellerstein, *State Taxation I* § 9.10 (2d ed. 1993), no one would seriously suggest that this is an unexpected phenomenon, much less a "taking" requiring "just compensation."

the Fifth Circuit virtually ignored the significance of the regulatory context in which client trust funds are deposited, and simply relied on the rule "interest follows principal."

The Fifth Circuit's opinion abandons the "reasonable expectation" component of this Court's takings analysis and creates a split among the circuits as to whether such component remains a requirement of this Court's takings analysis. The Court should grant the writ to resolve such conflict.

II. THE FIFTH CIRCUIT'S ANALYSIS AND DECISION CONFLICT WITH IMPORTANT PRINCIPLES OF COMITY AND FEDERALISM

This Court has frequently recognized the need to respect the division of the state and federal judiciaries into their own spheres of delegated authority. It is important to a cooperative judicial federalism to avoid federal court error in deciding state-law questions antecedent to federal constitutional issues wherever possible. *Arizonans for Official English v. Arizona*, 65 U.S.L.W. 4169 (March 3, 1997) (urging resort to certification where federal court is asked to construe "a novel state Act not yet reviewed by the State's highest court").¹⁰ In this case, the Fifth Circuit ignored the expectations of a co-equal sovereign by supplanting findings of the Texas Supreme Court with its own determination of policy in lieu of state law. This hardly comports with a fair notion of comity, much less with the Rules of Decision Act. See 28 U.S.C. § 1652. Although the Fifth Circuit began its consideration whether a property right existed in the interest on an IOLTA account

¹⁰ On motion for rehearing, Petitioners suggested that, if the Fifth Circuit was not persuaded that the Texas Supreme Court had already spoken authoritatively on the issue in its Order adopting the Texas IOLTA Program and when it passed the rules establishing the program, certification of the question whether state law recognized a property interest in interest on IOLTA deposits should be made to the Texas Supreme Court.

with a generic statement from Texas law, "interest follows principal," its discussion of Texas law of property ended abruptly. The Fifth Circuit panel failed to note that the generic rule of "interest follows principal" has its exceptions. For example, while Texas law respects the property of a spouse held before marriage as separate property subject to his or her exclusive control, the interest earned on separate property during marriage is community property and may be distributed to the other spouse in the discretion of the court upon divorce. *E.g.*, *In re Levi*, 183 B.R. 468, 472 (Bankr. N.D. Tex. 1995); *Mortenson v. Trammel*, 604 S.W.2d 269, 275 (Tex. Civ. App. — Corpus Christi 1980, writ ref'd n.r.e.); *Lesage v. Gaeley*, 287 S.W.2d 193, 196 (Tex. Civ. App. — Waco 1956, writ dism'd). Hence, interest, under Texas property law, does not always follow principal in the context of community property. Indeed, an earlier Fifth Circuit panel reached the same conclusion. *Broday v. U.S.*, 455 F.2d 1097, 1099-1100 (5th Cir. 1972) (applying Texas law). A decision defining property rights under state law should be the constitutional prerogative of the state, not that of a federal court making its own policy determinations.

Rather than explore the rationale upon which the Texas Supreme Court founded the Texas IOLTA Program and the property interest implications of that rationale, the court of appeals below embarked on its own policy-making analysis and concluded that it did not agree, for its own policy reasons, with the premises upon which IOLTA is based. For example, under the Texas IOLTA Program, like IOLTA programs across the nation, tax reporting costs are an important determinant in whether particular funds are eligible for an IOLTA account. However, rather than giving deference to the Texas Supreme Court's determination of rights to interest on client funds, the court of appeals below decided it was "short-sighted" and "unacceptable" to rely upon a "fickle" tax code. The court stated: "we also note that under the current IOLTA program, tax law seemingly defines property . . . [w]e find

no basis to hinge property interests on the fickle tax code. . . . [t]his short-sighted view of property renders it unacceptable." 94 F.3d at 1004 n.47; Pet. App. pp. 16-17. Moreover, the court of appeals decided that it was unwise for the Texas Supreme Court to capitalize on an anomaly in banking regulations in creating the Texas IOLTA program: "we are also hesitant to declare that such interest is not property lest we incite a new gold rush, encouraging government agencies to dissect banking regulations to discover other anomalies that lead to 'unclaimed' interest." 94 F.3d at 1003; Pet. App. p. 15.

In determining state law, however, federal courts must follow the rules of decision of the state courts, particularly the highest appellate courts of the states. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), *see also Or. ex rel. State Land Board v. Corvallis Sand and Gravel Co.*, 429 U.S. 363, 378-379 (1977) (property ownership is not governed by a general federal law but by state law) (Rehnquist, J.). The Fifth Circuit made virtually no effort to explore Texas property law or any expectations, reasonable or otherwise, that a client might have to a proportional share of aggregated interest on a deposit that could not yield net interest on an attributed basis. Instead, the Fifth Circuit deemed all interest to be property of the beneficial owner of the principal, relying exclusively on a decision of this Court, whose facts were clearly distinguishable. The Texas Supreme Court, however, had specifically approved of the Texas IOLTA Program after *Webb's* was decided. In fact, in its Order amending the State Bar Rules thereby creating the Texas IOLTA Program, the Texas Supreme Court specifically found that

on certain client funds held by attorneys, interest income cannot reasonably be earned to benefit individual clients for whom the funds are held. . . .

(Appendix F). The IOLTA program in Texas and in other states was specifically crafted so as to reach only those deposits that, standing alone, could not generate

interest income in excess of the cost of administrative fees. Thus, the only expectation of interest on these funds results from their being aggregated into a pooled account benefiting a single eligible non-profit organization. Had the Fifth Circuit deferred to the state court's findings on this antecedent question of state law, the constitutional questions presented would not arise. By removing state law from the analysis (or simply affording the state's highest court no deference in the analysis), the Fifth Circuit has started down a path foreclosed by this Court in *Erie*, seeking to create a general federal law of property in the shadows of the Fifth Amendment.

This Court should grant the writ to confirm the deference a federal court should pay to a state's highest appellate court when deciding an issue of state law, particularly when the issue is antecedent to federal constitutional issues.

CONCLUSION

For the foregoing reasons a writ of certiorari should issue, the decision of the court of appeals below should be reversed and the decision of the District Court affirmed in all respects.

Respectfully submitted,

NAKCY TREASE
Office of the Attorney General
of Texas
P.O. Box 12548, Capitol Station
Austin, TX 78711
(512) 475-4075

Attorneys for Petitioners
Hon. Thomas R. Phillips,
Hon. Raul A. Gonzalez,
Hon. Jack Hightower,
Hon. Nathan L. Hecht,
Hon. Lloyd Doggett,
Hon. John Cornyn,
Hon. Bob Gammage,
Hon. Craig T. Enoch, and
Hon. Rose Spector

DARRELL E. JORDAN
H. ROBERT POWELL *
BRITTAN L. BUCHANAN
DAVID J. SCHENCK
HUGHES & LUCE, L.L.P.
111 Congress, Suite 900
Austin, Texas 78701
(512) 482-6800

Attorneys for Petitioners
Texas Equal Access to Justice
Foundation, and W. Frank
Newton, in His Official
Capacity as Chairman of the
Texas Equal Access to Justice
Foundation

April 4, 1997

* Counsel of Record

APPENDICES

1a

APPENDIX A

**UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT**

No. 95-50160

WASHINGTON LEGAL FOUNDATION;
WILLIAM R. SUMMERS; MICHAEL J. MAZZONE,
Plaintiffs-Appellants,

v.

TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION; W.
FRANK NEWTON, Chairman, Texas Equal Access to
Justice Foundation; THOMAS R. PHILLIPS, Chief Justice;
RAUL GONZALEZ, Justice; JACK HIGHTOWER, Justice;
NATHAN L. HECHT, Justice; LLOYD A. DOGGETT, Jus-
tice; BOB GAMMAGE, Justice; CRAIG T. ENOCH, Justice;
JOHN CORNYN, Justice; ROSE SPECTOR, Justice; Su-
preme Court DFTS,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Texas

Sept. 12, 1996

Before WISDOM, GARWOOD and JONES, Circuit
Judges.

WISDOM, Circuit Judge:

The plaintiffs-appellants appeal the district court's
denial of their motion for summary judgment and the

court's award of summary judgment to the defendants-appellees, in which the district court upheld the constitutionality of the Texas statute, Interest on Lawyers Trust Accounts Program (IOLTA), and found that the defendants are entitled to limited immunity under the Eleventh Amendment. For the reasons that follow, we REVERSE the judgment of the district court in part, VACATE and remand in part, and AFFIRM in part.

I.

Statement of Facts

Clients often give their attorneys money to be held in escrow, such as retainer fees or closing costs for a transaction. In Texas, traditional ethical rules require attorneys to place this money in a trust account that permits withdrawal on demand. The ethical rules also allow attorneys to aggregate all client funds into a single trust account and prohibit attorneys from commingling their own money with the trust fund. Because federal law prohibited banks from paying interest on demand accounts,¹ these accounts formerly amounted to interest-free loans to the banks.

In 1980, new banking regulations allowed negotiable order of withdrawal (NOW) accounts,² which operate as interest-bearing checking accounts. NOW accounts created a vehicle for attorneys to pool client funds into an interest-bearing trust account, provided that none of the funds belong to a for-profit corporation.³ Attorneys, how-

¹ S.REP. No. 96-368, 9th Cong., 2d Sess. 5, reprinted in 1980 U.S.C.C.A.N. 240, 240.

² Depository Institutions Deregulation and Monetary Control Act of 1980, 94 Stat. 132, 146 (codified as amended at 12 U.S.C.A. § 1832 (West 1989)); see also S.REP. No. 96-368, reprinted in 1980 U.S.C.C.A.N. at 242-43.

³ See 12 U.S.C.A. § 1832(a)(2) (permitting NOW accounts to consist of commingled funds belonging to numerous individuals or non-profit organizations or both).

ever, may not deduct the costs of maintaining the trust account from the interest earned, because such a practice would constitute an impermissible benefit from the management of the trust account in violation of the ethical rules.

The creation of NOW accounts led to the development of IOLTA programs. The IOLTA concept arises from the premise that there are still situations in which, because of the nominal amount of a client's funds to be held or the brief period for which a client's funds will be held, NOW accounts are not feasible; the costs of maintaining such accounts outweigh the interest that each client would have earned. In these situations, the trust accounts still operated as interest-free loans to the banks. IOLTA is an attempt to switch this benefit from the banks to legal providers for the indigent.

Under its statutory power to regulate the state bar, the Texas Supreme Court created its IOLTA program in 1984, which is modeled after IOLTA programs used in other states and which seeks to capitalize on this banking anomaly. The IOLTA program originally permitted attorneys to place client funds that were "nominal in amount" or were "reasonably anticipated to be held for a short period of time" into an unsegregated interest-bearing bank account (IOLTA account), the interest of which is paid to the Texas Equal Access to Justice Foundation (TEAJF), a non-profit corporation created by the Texas Supreme Court.⁴ At that time, Texas's IOLTA program was voluntary, meaning that an attorney could choose whether to participate but clients had no choice, other than to select an attorney who did not maintain an IOLTA account.

⁴ See TEX.GOV'T CODE ANN. tit. 2, subtit. G, app. A, art. 11 §§ 6-7 (1987). Attorneys must make a reasonable determination as to whether a client's funds are nominal in amount or only to be held for a short period of time. When this determination is made in good faith, then an attorney cannot be liable for this decision. *Id.* § 7.

The TEAJF's purpose is to manage and distribute the interest earned from the IOLTA accounts to non-profit organizations that "have as a primary purpose the delivery of legal services to low income persons",⁶ with the exception that no funds may be used to finance class action lawsuits or to lobby on behalf of a political candidate or issue.⁶ Nearly all states have similar systems, which were designed to provide much-needed finances to legal providers for the impoverished. States have drastically slashed the budgets for such programs over the years; in 1993, the Texas legislature even refused to enact a modest increase in court filing fees to compensate for temporary IOLTA shortfalls.

Initially, the Texas IOLTA program did not meet expectations. Attorneys were reluctant to deposit their client funds into IOLTA accounts and impoverished Texas citizens still were unable to obtain legal assistance because of a lack of resources. Texas's voluntary IOLTA program yielded only \$1 million per year. Following the lead of several other states and the recommendation of the American Bar Association, in 1988, the Texas Supreme Court made attorney participation in the IOLTA program mandatory, requiring that attorneys deposit client funds in IOLTA accounts under certain circumstances.⁷ The revised rules, which became effective in 1989, state that

⁶ TEXAS RULES OF COURT—STATE, Rules Governing the Operation of the Texas Equal Access to Justice Program [TEAJF rule] rule 10 (West 1996).

⁶ *Id.* rule 15. The TEAJF, however, may provide funds "to finance suits against governmental entities on behalf of individuals in order to secure entitlement to benefits", such as Social Security, Medicaid, and public housing. *Id.*

⁷ Attorneys and law firms must open their own IOLTA accounts at a financial institution and direct the depository institution "to remit, at least quarterly, interest earned on the average daily balance in the account, less reasonable service charges" to the TEAJF. TEAJF rules 7, 9.

[a]n attorney . . . receiving in the course of the practice of law . . . client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time, *shall* establish and maintain a separate interest-bearing demand account at a financial institution and *shall* deposit in the account all those client funds.⁸

The rules further guide an attorney's decision as to whether funds are suitable for deposit in an IOLTA account, stating that a client's funds may be deposited in an IOLTA account only if

such funds, considered without regard to funds of other clients which may be held by the attorney . . . , could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client.⁹

Under the mandatory IOLTA program, Texas realized a dramatic increase in IOLTA revenue, with recent earnings of approximately \$10 million per year. The TEAJF distributes these funds to various non-profit organizations who apply to the TEAJF for funding.

Procedural History

The plaintiffs' objections to the activities of some of the IOLTA fund recipients, such as those groups providing legal aid to refugees seeking political asylum in the United States and those organizations assisting death row

⁸ TEX. GOV'T CODE ANN. tit. 2, subtit. G, app. A, art. 11 § 5 (West Supp.1995) (emphasis added).

⁹ TEAJF rule 6.

inmates to challenge their death sentences, prompted them to bring this suit.¹⁰ The plaintiffs allege that the IOLTA program constitutes an impermissible taking of property, in violation of the Fifth Amendment of the United States Constitution, and that the program also forces them to support speech that they find offensive, in violation of the First Amendment. The plaintiffs request compensation for the interest proceeds that the Teaxs IOLTA program earned from their deposit and an injunction against the further application of the Texas IOLTA program.

The defendants¹¹ moved to dismiss the case for failure to state a claim. Though the district court denied this motion, it granted the defendants' subsequent motion for summary judgment and denied the plaintiffs' summary judgment motion. The district court, finding the logic of the First and Eleventh Circuits "compelling",¹² reasoned that there was no property interest at stake in the interest proceeds earned on funds deposited in IOLTA accounts.¹³ Having made this determination,

¹⁰ The plaintiffs consist of Michael J. Mazzone, a Texas attorney who regularly places clients' funds into an IOLTA account and who asserts that practical problems prevent him from practicing law without collecting nominal or short-term client funds; William J. Summers, a Texas citizen who has funds currently held in an IOLTA account and who regularly uses Texas attorneys; and the Washington Legal Foundation, a public interest law firm whose members are similarly situated to Mazzone and Summers.

¹¹ In its suit, the plaintiffs named as defendants the TEAJF; W. Frank Newton, the director of the TEAJF; and all the Justices of the Texas Supreme Court.

¹² *Washington Legal Found. v. Texas Equal Access to Justice Found.*, 873 F.Supp. 1, 6-7 (W.D.Tex.1995) (citing *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962, 975-76 (1st Cir.1993) and *Cone v. State Bar of Fla.*, 819 F.2d 1002, 1004 (11th Cir.), cert. denied, 484 U.S. 917, 108 S.Ct. 268, 98 L.Ed.2d 225 (1987)).

¹³ *Id.* at 7.

the district court then dismissed the plaintiffs' First and Fifth Amendment arguments.¹⁴ The district court concluded by holding that the TEAJF is entitled to Eleventh Amendment immunity against all of the plaintiffs' claims and that Newton is subject only to the plaintiffs' claims of injunctive and prospective relief. The plaintiffs now appeal the district court's decision.

II.

It has been suggested that the IOLTA program represents a successful, modern-day attempt at alchemy.¹⁵ While legends abound concerning the ancient, self-professed alchemists who worked tirelessly towards their goal of changing ordinary metal into precious gold, modern society generally scoffs at this attempt to create "something from nothing." The defendants in this case denounce such skepticism, declaring that they have unlocked the magic that eluded the alchemists. The alchemists failed because the necessary ingredients for their magic did not exist in historical times: the combination of attorney's client funds and anomalies in modern banking regulations. According to the defendants' theory, the interest proceeds generated by Texas's IOLTA accounts exist solely because of an anomaly in banking regulations and, until the creation of the IOLTA program, that interest belonged to no one. The defendants then contend that Texas used the IOLTA program to stake a legitimate claim to these funds and that the plaintiffs cannot now seek to repossess the fruits of this magic as their own. We, however, view the IOLTA interest proceeds not as the fruit of alchemy, but as the fruit of the clients' principal deposits.

State law defines "property" and the United States Constitution protects private property from government

¹⁴ *Id.* at 8, 10.

¹⁵ AMERICAN BAR ASS'N. CIVIL JUSTICE: AN AGENDA FOR THE 1990's 56-72 (1989).

encroachment.¹⁶ Texas observes the traditional rule that "interest follows principal", which recognizes that interest earned on a deposit of principal belongs to the owner of the principal.¹⁷ In light of this rule, it seems obvious that the interest earned in the IOLTA accounts is the property of the clients whose money is held in those accounts; nevertheless, the district court adopted the theory espoused by the First and Eleventh Circuits, which circumvents this rule. The district court concluded that the plaintiffs cannot "have a [cognizable] property interest in interest proceeds that, but for the IOI.TA Program, would have never been generated".¹⁸ This reasoning, though, does not give proper weight to Supreme Court precedent.

In *Webb's Fabulous Pharmacies v. Beckwith*, the Supreme Court addressed a similar situation.¹⁹ The case arose when the purchase of Webb's Fabulous Pharmacies faltered because, at the closing, the purchaser learned that Webb's had substantial debt that was not previously revealed. The purchaser then filed a complaint of interpleader in Florida state court and tendered the \$1.8 million purchase price to the clerk of court. Florida law required the clerk to place the interpleaded funds into an interest-bearing account, to retain the interest earned for the court, and to deduct statutorily-defined fees for maintaining the funds. During the following year while the matter was being resolved, the interpleaded funds earned over \$100,000 in interest. The court then appointed a receiver for Webb's, who promptly demanded that the

¹⁶ *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155, 161, 101 S.Ct. 446, 450-51, 66 L.Ed.2d 358 (1980) (citing *Board of Regents v. Roth*, 408 U.S. 564, 577, 92 S.Ct. 2701, 2709, 33 L.Ed.2d 548 (1972)).

¹⁷ E.g., *Sellers v. Harris County*, 483 S.W.2d 242, 243 (Tex.1972).

¹⁸ *Washington Legal Found.*, 873 F.Supp. at 7 (citing *Massachusetts Bar Found.*, 993 F.2d at 980; *Cone*, 819 F.2d at 1005-07).

¹⁹ 449 U.S. 155, 101 S.Ct. 446, 66 L.Ed.2d 358 (1980).

clerk deliver the funds to him. The clerk surrendered the funds, but withheld approximately \$10,000 for administrative fees and the \$100,000 in interest that had accrued. The creditors then filed suit in state court to recover the interest. Ultimately, the Florida Supreme Court ruled against the creditors, holding that there was no unconstitutional taking because money deposited with the clerk was public money, interest earned on public money was not private property, and the statute only took that which it created.²⁰ This decision prompted the creditors to appeal to the United States Supreme Court.

The Supreme Court began by noting that the principal deposited with the clerk clearly constituted private property under Florida law.²¹ The Court then determined that because the principal was "held only for the ultimate benefit of Webb's creditors, not for the benefit of the court"²² and eventually would be distributed to them, state law gave the creditors a property interest proportional to their share of the principal.²³

Having decided the ownership of the principal, the Court turned to the interest on the principal, "the fruit of the fund's use".²⁴ Reaching the opposite conclusion from that of the Florida Supreme Court,²⁵ the *Webb's* Court held that simply because the state ordered the placement of interpleaded funds into an interest-bearing ac-

²⁰ *Beckwith v. Webb's Fabulous Pharmacies*, 374 So.2d 951, 952-53 (Fla.1979) (per curiam), *rev'd*, *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155, 101 S.Ct. 446, 66 L.Ed.2d 358 (1980).

²¹ *Webb's Fabulous Pharmacies*, 449 U.S. at 160, 101 S.Ct. at 450.

²² *Id.* at 131, 101 S.Ct. at 451.

²³ *Id.*

²⁴ *Id.* at 162, 101 S.Ct. at 451.

²⁵ *Beckwith*, 374 So.2d at 953 (finding no unconstitutional taking because the IOLTA program only took the interest that it created).

count does not mean that the state can assert ownership of that interest.²⁶ Recognizing that "[t]he usual and general rule [under Florida law] is that any interest on an interpleaded and deposited funds follows the principal and is to be allocated to those who are ultimately to be the owners of that principal," the Court ruled that "earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property".²⁷ The Court then concluded that the Florida law perpetrated an unconstitutional taking of the interest, which is the property of the creditors who own the principal.²⁸

After *Webb's*, numerous state courts debated the constitutionality of IOLTA programs. With the exception of the Indiana Supreme Court,²⁹ these courts agreed that *Webb's* was inapposite because of the difference in size between the deposit in *Webb's* and the funds eligible for deposit in IOLTA accounts.³⁰

²⁶ *Id.* at 162, 101 S.Ct. at 451.

²⁷ *Id.* at 162-63, 101 S.Ct. at 451-52.

²⁸ *Id.* at 163, 101 S.Ct. at 451-52.

²⁹ The Indiana Supreme Court refused to implement an IOLTA program, concluding that the program diverts clients' funds, because the interest proceeds belong to the clients, and convolutes attorneys' fiduciary duty to their clients. *In re Ind. State Bar Ass'n's Petition to Authorize a Program Governing Interest on Lawyers' Trust Accounts*, 550 N.E.2d 311, 312-15 (Ind.1990) (per curiam).

³⁰ See *In re Ark. Bar Ass'n Petition to Authorize a Program Governing Interest on Lawyer's Trust Accounts*, 283 Ark. 252, 675 S.W.2d 355, 357 (1984), modified, 289 Ark. 595, 709 S.W.2d 400 (1986); *Carroll v. State Bar of Cal.*, 166 Cal. App.3d 1193, 215 Cal.Rptr. 305, 312, cert. denied, 474 U.S. 848, 106 S.Ct. 142, 88 L.Ed.2d 118 (1985); *In re Interest on Trust Accounts*, 402 So.2d 389, 395-96 (Fla.1981); *Petition by the Mass. Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715, 718 (1985); *In re Petition of Minn. State Bar Ass'n*, 332 N.W.2d 151, 158 (Minn.1982); *Petition of N.H. Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258, 1261 (1982); *In re Interest on Lawyers' Trust Accounts*, 672 P.2d 406, 408 (Utah 1983). While forty-nine states and the District of Columbia have adopted

In 1987, the Eleventh Circuit considered the IOLTA issue in a suit challenging Florida's version of the IOLTA program.³¹ The Eleventh Circuit distinguished *Webb's* on the basis that *Webb's* involved the ownership of over \$100,000 in accrued interest, an amount that clearly exceeded any fees that were assessed.³² In contrast, the Florida IOLTA program only concerned deposits that were so small or short-term that the administrative costs of maintaining an interest-bearing NOW account for that deposit would exceed any interest earned.³³ Relying on this factual distinction, the Eleventh Circuit concluded that Florida's IOLTA program does not commit an unconstitutional taking, reasoning that the owner of principal has no legitimate expectation of earning interest on money deposited into a Florida IOLTA account because "the use of [the client's] money had no net value, therefore there could be no property interest for the state to appropriate".³⁴ According to the Eleventh Circuit, the use of the money had no net value because the IOLTA program only takes the interest from those deposits that do not produce interest in excess of the administrative expenses incurred.³⁵

an IOLTA program in one form or another, *In re Indiana State Bar Ass'n*, 550 N.E.2d at 311, most states adopted the program without opinion or through legislation.

³¹ *Cone*, 819 F.2d at 1002. The Florida IOLTA program was "voluntary", giving its attorneys the option of whether to participate. The clients, however had no choice, other than to choose an attorney who did not use the program. In *Cone*, the plaintiff paid her attorneys \$100 to probate her husband's estate. The attorneys failed to return \$13.75 of that amount to the plaintiff, which, during the following eleven years, earned \$2.25 in interest. The plaintiff's attorneys paid that interest to Florida's IOLTA program and the plaintiff sued to recover that interest.

³² *Id.* at 1007.

³³ *Id.* at 1006-07.

³⁴ *Id.* at 1007.

³⁵ *Id.* The First Circuit, in dicta, reached the same conclusion. See *Massachusetts Bar Found.*, 993 F.2d at 976. In that case, the

Although the Eleventh Circuit explicitly says otherwise,³⁶ inherent in its *Cone* analysis is the notion that the value of the alleged property involved determines whether there is a cognizable property interest. Under *Cone*, "property" is [erroneously] redefined as an interest that must necessarily benefit its owner".³⁷ The *Webb's* decision, however, creates a rule that is independent of the amount or value of interest at issue, holding that a property interest existed in the accrued interest simply because "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property".³⁸ We see no reason why this rule does not apply to the instant case.

First Circuit stated that the plaintiffs did not assert property rights in the IOLTA interest proceeds, but sought only to protect the right to exclude the state from the use of their principal. *Id.* at 975-76. The right to exclude is one of the sticks in the bundle of property rights. *Id.* The Court, nevertheless, held that the interest earned on IOLTA accounts was not the plaintiff's property, *id.* at 976, an issue that was not properly before it. The First Circuit employed reasoning that parallels the decision in *Cone*, concluding that the IOLTA interest belongs to no one. *Id.* at 980.

³⁶ *Cone*, 819 F.2d at 1007 (stating that the decision does not establish "a de minimis standard for Fifth Amendment takings").

³⁷ Mary O. Sinibaldi, Note, *The Takings Issue in California's Legal Services Trust Account Program*, 12 HASTINGS CONST.L.Q. 463, 492 (1985).

³⁸ *Webb's Fabulous Pharmacies*, 449 U.S. at 164, 101 S.Ct. at 452. The *Webb's* Court concluded by holding that the Florida statute appropriated "the value of the use of the fund for the period in which it is held". *Id.*; see also Sinibaldi, *supra* note 37, at 493.

The *Cone* Court was correct to note that the value of the property involved does not effect the determination of whether a property interest exists; indeed, the Supreme Court rejected this position in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 102 S.Ct. 3164, 73 L.Ed.2d 868 (1982), in which the Court held that "constitutional protection for the rights of private property cannot be made to depend on the size of the area permanently occupied". *Id.* at 436, 102 S.Ct. at 3176-77 (ruling that an ordinance requiring landlords to allow cable television providers to

The *Cone* court also failed to consider the precise events of the transaction, concluding that the only protectable property interest in interest proceeds attaches to the amount of interest that remains after a bank deducts its charges from the interest earned, because the owner of the principal only has a legitimate expectation of receiving those interest proceeds.³⁹ It appears, however, that a bank pays interest on the account and then deducts fees. It is a two-part process. As a result, a property interest attaches the moment that the interest accrues, from which the bank then deducts its charges from the depositor's account. Furthermore, the *Webb's* Court noted that Florida was under no obligation to place the interpleaded funds into an interest-bearing account, but once it did so, then any interest earned belongs to the depositor. The same rule applies to IOLTA accounts. Ethical rules historically demanded that attorneys hold their clients' funds in trust accounts, choosing the type of account in accordance with the best interests of the client.

install small cable boxes on the roofs of their buildings was a permanent physical occupation, thereby entitling the landlords to compensation despite the small area appropriated and the fact that the installation actually enhanced the value of the buildings).

The defendants in the instant case suggest that *Loretto* does not govern IOLTA because money, unlike real property, is fungible and deductions from the IOLTA account are not physical appropriations of property. *Cf. United States v. Sperry Corp.*, 493 U.S. 52, 62 n. 9, 110 S.Ct. 387, 394-95 n. 9, 107 L.Ed.2d 290 (1989) (holding that the government did not perpetrate a taking when it deducted a statutory fee from the plaintiff's award by the Iran-United States Claims Tribunal instead of requiring the plaintiff to pay the fee separately). This argument is inappropriate because this suit does not concern the constitutionality of deductions for the maintenance of the IOLTA accounts, but rather addresses the ownership of the interest generated. *See id. Sperry* merely confirms that the state may charge fees to those who use its services, and may deduct those fees directly from any amount due to the user.

³⁹ *Cone*, 819 F.2d at 1007.

If attorneys still had this latitude, clients could not complain that a taking occurred when the attorney placed their funds in a non-interest bearing account, because until the interest accrues, the clients have no cognizable property right in the interest.⁴⁰ The Texas IOLTA program, however, requires attorneys to place certain client funds into an IOLTA account and then takes the interest that accrues for itself. In such a case, the plain rule is that the interest proceeds, once they have accrued, belong to the owner of the principal.

The defendants additionally argue that finding a property interest in the IOLTA interest overlooks the fact that, for practical banking reasons, the interest earned in trust accounts could never accrue to the clients. This argument ignores one of the critical driving forces of IOLTA: IOLTA programs became possible only with the announcement of Internal Revenue Service ruling 81-209.⁴¹ In this ruling, the I.R.S. agreed that clients would not be taxed on the interest earned on their deposits in IOLTA accounts provided that they had no choice but to participate in the program.⁴² By the terms of this ruling, if clients have any control over the interest generated from their nominal and short-term deposits into IOLTA accounts, then the interest generated is taxable income.⁴³

⁴⁰ See *Webb's Fabulous Pharmacies*, 449 U.S. at 161, 101 S.Ct. at 451 ("[A] mere unilateral expectation . . . is not a property interest entitled to protection.")

⁴¹ Rev.Rul. 81-209, 1981-2 C.B. 16; see also Rev.Rul. 87-2, 1987-1 C.B. 18 (restating the decision announced in Rev.Rul. 81-209).

⁴² Rev.Rul. 81-209, 1981-2 C.B. at 17 (justifying the tax-exempt status of IOLTA interest because under IOLTA plans, "no client may individually elect whether to participate in the program" and "bars clients from receiving the benefit of any interest earned").

⁴³ The I.R.S. was concerned about IOLTA programs providing a means to assign income and to avoid taxes on that income. By prohibiting clients from having any control over IOLTA funds, the I.R.S. is satisfied that the assignability problem is mooted.

To prevent this situation, Texas gave itself an IOLTA monopoly, reserving all the IOLTA interest proceeds for itself and requiring all of its attorneys to participate in the program. If private charities were to establish private IOLTA programs and clients could choose the program to which their funds went, then clients suddenly would have taxable income. Applying the defendants' arguments to such a scenario, the IOLTA funds would be too minimal to return to the clients, therefore falling outside of the *Cone* definition of property, yet clients still would have to pay income tax on the interest earned, interest which *Cone* would say was not their property. This situation flies in the face of reason.

We are also hesitant to declare that such interest is not property lest we incite a new gold rush, encouraging government agencies to dissect banking regulations to discover other anomalies that lead to "unclaimed" interest. One possible source is the interest earned by banks during the float time of checks. Consider a customer who deposits a check drawn on a payor bank with a depository bank. "In a simple case, where the Federal Reserve Bank is the only intermediary, the depository bank will present that check to the Fed and receive a [provisional] credit in its reserve account."⁴⁴ The Fed then presents the check to the payor bank, whose account is debited and the payor bank must send notice of dishonor within the defined period or be liable for the amount.⁴⁵ Typically, this process takes one to two days, during which time the depository bank has a provisional credit from the Federal Reserve in the amount of the check. Until recently, depository banks were not required to pay interest to their customers during the time between the deposit of funds and the payor banks' deadline to send the notice

⁴⁴ Robert D. Cooter & Edwin L. Rubin, *Orders and Incentives as Regulatory Methods: The Expedited Funds Availability Act of 1987*, 35 U.C.L.A.L.REV. 1115, 1127 (1988).

⁴⁵ See *id.*

of dishonor, effectively giving the depository banks an interest-free loan on the deposited funds during that time because the depository banks could treat the provisional credit like cash reserves. This interest-free loan appears very similar to the one that the Texas Supreme Court sought to exploit with the IOLTA program and the interest earned on some checking accounts conceivably could fall below any benefits received, creating an IOLTA-like situation. While depository banks now must pay interest on deposits from the time that they receive provisional credit from the Fed, credit unions are exempt from this requirement and still receive the benefit of these "interest-free loans".⁴⁶

This is only one example of another "anomaly" in the banking industry and we cannot believe that such anomalies each create funds that belong to nobody. The traditional rule that interest follows principal must apply because that rule compensates the owners of the principal for the use of their funds. If a bank customer chooses, however, to allow the bank to profit in this manner, that decision does not give the state carte blanche to claim that property as its own. As technology continues to advance, the speed with which such transactions can occur will continue to increase, providing greater opportunities for states to try to collect the fractions of pennies that could be earned as interest during the float time of all these activities. Indeed, the faster the funds move, the more and more difficult it will be for individuals to make a practical claim to such funds. Nevertheless, the rule remains the same: any interest that accrues belongs to the owner of the principal, unless they agree otherwise.⁴⁷

⁴⁶ See 12 U.S.C.A. § 4005 (a), (b) (West 1989).

⁴⁷ Furthermore, we also note that under the current IOLTA program, tax law seemingly defines property. If interest was no longer taxed, banks would not have to send 1099s, thereby greatly decreasing the administrative costs of IOLTA accounts. In this

III.

The district court's decision on the merits is wholly premised on the notion that clients do not have a valid property interest in the interest proceeds on funds in IOLTA accounts. Having rejected this premise, we vacate the district court's award of summary judgment to the defendants and denial of summary judgment to the plaintiffs. We remand this case for reconsideration in the light of the principles explained in this decision and for further factual development of the record, such as the clarification of the types of account pooling permitted by the TEAJF rules.

With respect to the merits of the plaintiffs' claims, we note that to prevail on their taking claim, the plaintiffs must demonstrate that the taking was against the will of the property owner.⁴⁸ That or a similar showing would also likely be necessary to prevail on their First Amendment claim. We express no opinion as to whether such a showing has been, or can be, made in the context of this case. We leave these and such other issues as may surface to be addressed in the first instance by the district court on remand.

IV.

Finally, the district court also granted the defendants' request for immunity under the Eleventh Amendment with respect to the plaintiffs' claim for monetary restitution.

case, nearly all deposits would earn interest and clients clearly would be entitled to their funds. We find no basis to hinge property interests on the fickle tax code. Under the current scheme, any change in the costs to banks of managing small deposits would impact the determination of whether a property right in IOLTA interest exists. See Kenneth P. Kreider, Note, *Florida's IOLTA Program Does Not "Take" Client Property for Public Use*, 57 U.CIN.L.REV. 369, 391-93 (1988). This short-sighted view of property renders it unacceptable.

⁴⁸ See *Yee v. City of Escondido*, 503 U.S. 519, 527, 12 S.Ct. 1522, 1528, 118 L.Ed.2d 153 (1992).

The parties now only dispute whether the district court erred by declaring the defendants immune to the plaintiffs' restitution claim. The parties do not seriously challenge this portion of the district court's ruling; the defendants concede that they are subject to the plaintiffs' prospective injunction claims and the plaintiffs admit that their "principal concern all along has been in obtaining prospective injunctive relief." We suggest another reason for the parties' lackadaisical approach to this part of the decision: they realize that the district court is correct.

The Eleventh Amendment shields states and their agencies from suits in federal court without the states' consent.⁴⁹ Initially, we note that the Texas Supreme Court is entitled to Eleventh Amendment immunity.⁵⁰ This immunity extends to the TEAJF because the Texas Supreme Court created the TEAJF pursuant to its rule-making authority and the TEAJF acts on behalf of the Texas Supreme Court to carry out its role, which the Texas Supreme Court defined.⁵¹ Similarly, defendant Newton is entitled to immunity because he is being sued in his official capacity as chairman of the TEAJF, and therefore is also a state actor. The immunity that applies, as held by the district court, is limited and protects the defendants only from the plaintiffs' claims for reimbursement because the Eleventh Amendment does not protect the state from federal suits seeking injunctive relief.⁵²

⁴⁹ *Word of Faith World Outreach Ctr. Church v. Morales*, 986 F.2d 962, 965 (5th Cir.), cert. denied, 510 U.S. 823, 114 S.Ct. 82, 126 L.Ed.2d 50 (1993).

⁵⁰ See *Lewis v. Louisiana State Bar Ass'n*, 792 F.2d 493, 497 (5th Cir.1986).

⁵¹ See *id.* at 497 & n. 4.

⁵² *Word of Faith*, 986 F.2d at 965 (5th Cir.); see also *Lewis*, 792 F.2d at 497. The parties also disagree over whether the plaintiffs are entitled to monetary relief under their 42 U.S.C. § 1983 claim for monetary damages. Because neither a state nor state officials sued in their official capacity are "persons" within the

Accordingly, we hold that the district court did not err on this issue.

V.

For the foregoing reasons, we find that the district court erred by holding that the clients do not have a cognizable property interest in the interest proceeds that are earned on their deposit in IOLTA accounts. We VACATE the district court's award of summary judgment for the defendants and denial of summary judgment for the plaintiffs and REMAND for further consideration. Finally, we AFFIRM the limited immunity that the district court granted to the defendants.

meaning of § 1983 when the relief sought is monetary, the plaintiffs cannot recover their claim for reimbursement from the defendants. See *Will v. Michigan Dep't of State Police*, 491 U.S. 58, 69-71 & n. 10, 109 S.Ct. 2304, 2311-12 & n. 10, 105 L.Ed.2d 45 (1989).

APPENDIX B

UNITED STATES DISTRICT COURT
W.D. TEXAS
AUSTIN DIVISION

Civ. No. A-94-CA-081 JN

WASHINGTON LEGAL FOUNDATION,
MICHAEL J. MAZZONE, and WILLIAM R. SUMMERS

v.

TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION, W.
FRANK NEWTON, THOMAS R. PHILLIPS, RAUL A. GON-
ZALEZ, JACK HIGHTOWER, NATHAN L. HECHT, LLOYD
DOGGETT, JOHN CORNYN, BOB GAMMAGE, CRAIG T.
ENOCH and ROSE SPECTOR

Jan. 19, 1995

MEMORANDUM ORDER AND JUDGMENT

NOWLIN, District Judge.

Before the Court are the Motion for Summary Judgment filed by Defendant Texas Equal Access to Justice Foundation's ("TEAJF") and Defendant W. Frank Newton, its chair, the Motion for Summary Judgment filed by Defendants Thomas Phillips, Raul Gonzalez, Jack Hightower, Nathan Hecht, Lloyd Doggett, John Cornyn, Bob Gammage, Craig Enoch, and Rose Spector ("the Supreme Court Defendants"),¹ and the Motion for Summary Judgment

¹ The Supreme Court Defendants' Motion for Summary Judgment simply adopts the positions taken by the TEAJF in its Motion for Summary Judgment.

ment filed by the Plaintiffs, Washington Legal Foundation, William R. Summers, and Michael J. Mazzone. Also before the Court are the Responses addressing these motions, and the Replies addressing these Responses. Having considered these pleadings, the evidence submitted by the parties, the arguments of counsel, and the relevant law, the Court enters the following decision.

NATURE OF THE CASE

The Plaintiffs in this action are the Washington Legal Foundation, a self-described non-profit public interest law and policy center, Michael Mazzone, a Texas resident and attorney licensed to practice by the Texas Bar, and William Summers, a Texas resident and consumer of legal services rendered by members of the Texas Bar. The Plaintiffs have filed this action pursuant to 42 U.S.C. § 1983, claiming that the Texas Interest on Lawyers' Trust Accounts ("IOLTA") Program, which is implemented and overseen by the Texas Equal Access to Justice Foundation ("TEAJF"), violates their rights under the First and Fifth Amendments of the United States Constitution. In addition to a declaratory judgment finding the IOLTA Program unconstitutional, the Plaintiffs seek injunctive relief prohibiting mandatory participation in the IOLTA Program, a return of the full amount of interest earned on Plaintiffs' money placed in IOLTA trust accounts, and an award of costs and attorneys' fees.

The Defendants have responded that the IOLTA Program neither effects a taking of the interest generated by the Program in violation of the Fifth Amendment, nor compels speech or involuntary association in violation of the First Amendment. The Defendants alternately contend that the IOLTA Program serves a significant state interest through means narrowly tailored to serve that interest, and, accordingly, there is no First Amendment violation. Finally, the Defendants contend that they are entitled to Eleventh Amendment immunity and that the

TEAJF Defendants are not "persons" subject to suit under 42 U.S.C. § 1983.

SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate if the record discloses "that there is no genuine issue of material fact, and the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). To determine whether there are genuine fact issues, the court must first consult the applicable law to ascertain what issues are material. *Lavespere v. Niagara Machine & Tool Works*, 910 F.2d 167, 178 (5th Cir.1990), *cert. denied*, — U.S. —, 114 S.Ct. 171, 126 L.Ed.2d 131 (1993), *abrogated on other grounds*, *Little v. Liquid Air Corp.*, 37 F.3d 1069 (5th Cir.1994). Next, the court must review the evidence on those issues, viewing the facts and inferences in the light most favorable to the nonmoving party. *Id.*

A party seeking summary judgment bears the initial burden of identifying those portions of the pleadings and discovery on file, together with any affidavits, which it believes demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325, 106 S.Ct. 2548, 2554, 91 L.Ed.2d 265 (1986). Once the movant carries its burden, the burden shifts to the nonmovant to show that summary judgment should not be granted. *Id.* at 324-25, 106 S.Ct. at 2553-54. While the Court must review the facts drawing all inferences most favorable to the party opposing the motion, *Reid v. State Farm Mut. Auto. Ins. Co.*, 784 F.2d 577, 578 (5th Cir.1986), that party may not rest upon mere allegations or denials in its pleadings, but must set forth specific facts showing the existence of a genuine issue for trial. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256-57, 106 S.Ct. 2505, 2514, 91 L.Ed.2d 202 (1986). Factual controversies are resolved in favor of the nonmoving party, but only when there is an actual controversy, that is, when both parties have submitted evidence

of contradictory facts. *Little*, 37 F.3d at 1075. However, the court does not, in the absence of any proof, assume the nonmoving party could or would prove the necessary facts. *Id.*

FACTUAL BACKGROUND

For the most part, the Parties concede that there is no dispute as to any material fact underlying this cause of action. The material facts relating to the operation of the Texas IOLTA Program are set out below.

Article XI of the Rules of the State Bar of Texas establishes the Texas Equal Access to Justice Program (hereinafter "the IOLTA Program"). Under this program, an attorney receiving client funds that are "nominal in amount" or "reasonably anticipated to be held for a short period of time" is required to place the funds in an unsegregated interest-bearing bank account. *See* State Bar Rules Governing Operation of Equal Access to Justice Program Rule 6. More specifically, the only funds eligible for the IOLTA Program are those which

could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client. *Id.*

Under the IOLTA rules, when a client tenders a nominal amount of funds, or funds that will be held for only a short term, the lawyer is obligated to first make an initial determination, using his or her good faith judgment, of whether such funds can be deposited into an account that could reasonably be expected to earn an amount of interest sufficient to offset the cost of establishing and maintaining the account. *Id.* For purposes of the Plaintiffs' claims, it is important to stress that the only funds eligible for deposit in an IOLTA account are those

that have no reasonable possibility of legally generating net interest income benefiting the client. Nothing prohibits an attorney from placing funds into a non-IOLTA account, if such funds are capable of generating net interest income to the client.²

Interest generated by these IOLTA accounts is to be paid to the Texas Equal Access to Justice Foundation, a non-profit corporation. *Id.*, Rule 9. The Foundation is charged with administering these funds, awarding them as grants to non-profit organizations that have a primary purpose of delivering legal services to low income persons. *Id.* Rules 10-12.³ As evidenced by the TEAJF's annual reports, the beneficiary organizations provide a wide range of legal services, ranging from providing legal assistance to permanent resident aliens seeking naturalization, to documentation for Central American refugees seeking

² The Plaintiffs contend that there is a genuine issue of material fact regarding whether the Texas IOLTA program permits Texas attorneys to employ the banking practice of sub-accounting as a means of generating net interest on deposited funds, and whether sub-accounting is a practical means of generating net interest for clients who deposit small amounts of money with their attorney. The Court finds that this issue of fact is not material and therefore does not preclude summary judgment. As conceded by the Defendants, any type of account that can earn interest beyond the costs of maintaining such account is beyond the scope of IOLTA's coverage. In other words, if sub-accounting or some other creative (but legal) banking practice or service permits nominal funds to earn net interest, the IOLTA Program and the Texas Bar do not prohibit Texas lawyers from making use of them, even if the result is the placement of these nominal funds in non-IOLTA accounts.

³ The professed goals of the IOLTA Program—meeting the unmet legal needs of indigent Texans—is indeed laudable. However the Court is conscious of Justice Holmes' warning that "(a) strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 416, 43 S.Ct. 158, 160, 67 L.Ed. 322 (1922).

asylum, to legal services to death row inmates, to various AIDS organizations.⁴

Originally, the Texas IOLTA Program was voluntary. However, with only voluntary participation by Texas lawyers, the Program generated insufficient funds to meet the legal needs of indigent Texans. Consequently, in 1988, the Texas Supreme Court entered an order amending the State Bar Rules and converting the voluntary IOLTA program into the mandatory program presently in operation.⁵

FIFTH AMENDMENT CLAIMS

The Plaintiffs allege that the IOLTA Program violates their Fifth Amendment rights by taking their property without just compensation. More specifically, the Plaintiffs allege both 1) that the Program effects a taking of the interest generated by the funds deposited into pooled

⁴ One of the Plaintiffs' principal objections to the IOLTA Program is that some of the recipient organizations advocate positions to which the Plaintiffs are politically or ideologically opposed, such as expanding the rights of undocumented aliens or broadening the scope of anti-discrimination causes of action. In this regard, it bears noting that the IOLTA Rules prohibit the granting of funds to finance class actions, lawsuits against government entities (except to secure entitlements), or lobbying. *See* IOLTA Rule 15. However, the TEAJF apparently exercises little if any control or administrative influence over the out-of-court self-promotions and solicitations of some vocal attorneys or representatives of the donee entities.

⁵ The need for the provision of legal services to low income persons, and possibly for a mandatory *pro bono publico* program for lawyers, have been prominent issues recently facing both the Texas Bar and the Texas Supreme Court. *See, e.g., State Bar of Texas, et al. v. Maria Gomez, et al.*, 891 S.W.2d 243 (Tex.1994). The Court surmises that the well-documented failures of the Texas Bar to meet the legal needs of needy Texans through voluntary activities, as well as the clamor for mandatory *pro bono* by some sectors of the Texas Bar have played a significant role in the implementation of the mandatory IOLTA Program presently under consideration.

IOLTA accounts, and 2) that the Program effects a taking of the "beneficial use" of their property by compelling them to deposit their funds in IOLTA accounts to generate income to support the Program.

The Fifth Amendment provides that private property shall not be taken for public use without just compensation. U.S. Const. amend. V.⁶ For there to be a "taking" within the purview of the Fifth Amendment, the government must interfere "with interests that (are) sufficiently bound up with the reasonable expectations" of the plaintiff asserting the deprivation. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 125, 98 S.Ct. 2646, 2659, 57 L.Ed.2d 631 (1978); see also *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. at 161, 101 S.Ct. at 450 ("[A] mere unilateral expectation or an abstract need is not a property entitled to protection."). In other words, the Plaintiffs must be able to assert a cognizable property interest to raise a Fifth Amendment takings claim. *Ruckelshaus v. Monsanto*, 467 U.S. 986, 1001, 104 S.Ct. 2862, 2871, 81 L.Ed.2d 815 (1984). Whether such an interest exists is a question of state law. See, e.g., *Webb's*, 449 U.S. at 161, 101 S.Ct. at 450 ("[P]roperty interests . . . are not created by the Constitution. Rather they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law . . .") (quoting *Board of Regents v. Roth*, 408 U.S. 564, 577, 92 S.Ct. 2701, 2709, 33 L.Ed. 2d 548 (1972)).

Ownership of IOLTA-Derived Interest

Whether the Plaintiffs' can prevail on their Fifth Amendment claim depends in large part upon the characterization and ownership of the interest generated by

⁶ This prohibition is made applicable to the states by the Fourteenth Amendment. *Webb's Fabulous Pharmacy, Inc. v. Beckwith*, 449 U.S. 155, 160, 101 S.Ct. 446, 450, 66 L.Ed.2d 358 (1980).

the funds deposited in the IOLTA accounts—that is, whether they have a cognizable property interest in the IOLTA account interest. There is, of course, no dispute that the nominal funds given by Plaintiff Summers (the client) to Plaintiff Mazzone (his attorney), and which are deposited in Mazzone's IOLTA account, are at all times the property of Summers. The critical issue is to whom the proceeds (i.e., the interest earned) from such funds belong.⁷

The Plaintiffs contend that the client possesses property rights in the interest derived from IOLTA accounts. In support of this proposition, the Plaintiffs rely primarily upon the Supreme Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 101 S.Ct. 446, 66 L.Ed.2d 358 (1980). *Webb's* involved a challenge to Florida statute which permitted a county to take as its own the interest accruing on an interpleader fund deposited in the registry of a county court. The interpleaded funds involved in *Webb's* generated interest in excess of \$100,000.00. The Supreme Court struck down the statute, holding that the earnings of interpleaded funds are incidents of ownership of the funds itself and are property in the Fifth Amendment context just as the interpleaded fund itself is property. *Webb's*, 449 U.S. at 160-65, 101 S.Ct. at 450-52. The rationale for the *Webb's* decision was based upon the "usual and general rule (that) any interest on an interpleaded and deposited fund follows the principal and is to be allocated to those who are ultimately to be the owners of that principal." 449 U.S. at 162, 101 S.Ct. at 451. On the basis of this holding, the Plaintiffs claim that they have a property interest in the interest earned on their nominal or short-term IOLTA funds.⁸

⁷ For purposes of this inquiry, it must at all times be kept in mind that, under the IOLTA Rules, the principal amounts at issue cannot be reasonably expected to earn net interest on their own.

⁸ The Plaintiffs point out that the Supreme Court cited as an example of this "usual and general rule" *Sellers v. Harris County*,

The principles enunciated in *Webb's* have been frequently invoked in challenges to IOLTA programs operating in other jurisdictions. Such invocations have been almost uniformly without success.⁹

In *Cone v. State Bar of Florida*, 819 F.2d 1002, 1004 (11th Cir.), cert. denied 484 U.S. 917, 108 S.Ct. 268, 98 L.Ed.2d 225 (1987), the Eleventh Circuit evaluated the applicability of the holding in *Webb's* to a Fifth Amendment challenge to the Florida Bar's Interest on Trust Accounts ("IOLTA") program.¹⁰ The Eleventh

483 S.W.2d 242 (Tex.1972) a decision of the Texas Supreme Court involving essentially the same operative facts as *Webb's*. In *Sellers*, the Texas Supreme Court ruled that the interest generated from \$1,000,000 in insurance policy proceeds that were interpleaded into a county court's registry belonged to the owner of the principal and not the county, which claimed it was entitled to the interest pursuant to state statute. These proceeds generated interest in excess of \$6,000.00 per month. *Sellers*, 483 S.W.2d at 242.

⁹ The supreme courts of all fifty states have examined the constitutionality, efficacy, and propriety of IOLTA programs. Forty-nine of these state courts have approved them in one form or another. The lone exception is the Indiana Supreme Court, which declined to adopt the state bar's proposed IOLTA program in a nonadversarial proceeding. See *In re Indiana State Bar Association's Petition to Authorize a Program Governing Interest on Lawyer's Trust Accounts*, 550 N.E.2d 311 (Ind.1990). However, contrary to the Plaintiffs' characterization of this opinion, the Indiana Supreme Court's refusal to adopt an IOLTA program was not predicated on constitutional grounds, but rather solely upon the court's view that the proposed IOLTA program was contrary to its interpretation of the ethical obligations of Indiana attorneys. See *id.* at 315 ("[L]et there be no question that the IOLTA program currently promoted by the Indiana Bar Association violates our Rules for the Discipline of Attorney and Rules of Professional Conduct."). This Court declines to consider the ethical implications of the Texas IOLTA Program as such questions are more properly raised before the entity charged with regulating the conduct of members of the Texas Bar—namely, the Texas Supreme Court. See TEX.GOV.CODE ANN. § 81.011(c) (Vernon 1988).

¹⁰ The Florida Bar's Interest On Trust Accounts program is similar in both purpose and operation to the Texas IOLTA program. See *Cone*, 819 F.2d at 1003.

Circuit found that, despite "superficial similarities," the *Webb's* decision had no application in the IOLTA context, due to the fact that the use of funds in an IOLTA account had no net value. *Cone*, 819 F.2d at 1007. As the circumstances surrounding the funds and related banking practices could not lead to a legitimate expectation of interest exclusive of administrative costs and expenses, there could be no property interest for the state to appropriate via the collection of interest earned on pooled IOLTA funds. *Id.* The court stated that there was no taking of property because, standing alone, the plaintiff's funds deposited in her attorney's IOLTA (IOLTA) account could not earn anything, and consequently, there could be no legitimate claim of entitlement. *Id.*

The holding and reasoning in *Cone* was cited with approval by the First Circuit in *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962, 975-76 (1st Cir.1993), a case involving another unsuccessful challenge to the Massachusetts Bar's IOLTA Program. The court also noted some "superficial similarities" between *Webb's* and the challenge to Massachusetts IOLTA program, but stressed a fundamental difference—namely, that the claimants in *Webb's* had property rights in the accrued net interest generated by the deposited funds, while in the IOLTA context, the property interests are essentially intangible. *Id.* In accordance with the decision in *Cone*, the First Circuit held that the Plaintiffs' claimed property rights in both the interest generated by their funds and the beneficial use of the funds deposited in IOLTA accounts were insufficient to support a Fifth Amendment claim.

The logic supporting both of these opinions is compelling. By definition, the only funds eligible for deposit in an IOLTA account are those which are incapable of earning net interest if deposited by themselves in an individual (non-pooled) account. Further, as stated above, for there to be a "taking" within the purview of the Fifth Amendment, the state action must interfere with interests

that are sufficiently bound up with the reasonable expectations of the person asserting the deprivation. This "reasonable expectation" of a property interest is foreclosed by the very wording and operation of the rules governing the IOLTA program—that is, if there is any reasonable expectation of realizing net interest on a sum, the sum is exempted from IOLTA coverage. Simply put, the Court cannot conclude that the Plaintiffs have a property interest in interest proceeds that, but for the IOLTA Program, would never have been generated. Without such a property interest, the Plaintiffs are unable to state a viable Fifth Amendment claim pertaining to their ownership of the interest generated by funds placed in IOLTA accounts.

The Court finds that in the case of the Texas IOLTA Program (as in the case of the Florida and Massachusetts program), it is only through combining small or short-term deposits that there is a possibility of creating interest. Put another way: such interest has been generated only by virtue of "an anomaly created by the practicalities of accounting, banking practices, and the ethical obligations of lawyers." *Washington Legal Foundation*, 993 F.2d at 980. It follows then that such interest income is not within the legitimate expectations of the owner of any one of the principal amounts. Accordingly, such amounts cannot be deemed to be appropriated by the IOLTA program.¹¹ In sum, the property rights of the Plaintiffs in this action and the claimants in *Webb's* are clearly different, and as there is no property interest or expectation appropriated, there is no taking for Fifth Amendment purposes. Accordingly, the Court finds that the Plaintiffs have failed to allege a cognizable Fifth Amendment takings claim with regard to the interest generated by funds placed in IOLTA accounts.

¹¹ See *Cone*, 819 F.2d at 1007: "IOLTA programs do not amount to a taking because they create interest which was not within the reasonable expectations of any one of the principal amounts."

The Plaintiffs cite two additional cases involving prison inmates as authority for the proposition that the client has a protectable property interest in the proceeds generated from funds deposited into an IOLTA account. In *Tellis v. Godinez*, 5 F.3d 1314 (9th Cir. 1993), *cert. denied* — U.S. —, 115 S.Ct. 354, 130 L.Ed.2d 309 (1994) a prisoner brought suit against prison officials alleging that they violated his due process rights by withholding interest earned on funds in his personal bank account. The Ninth Circuit recognized that the prisoner did indeed have a property right in the interest generated by his funds. However, the Ninth Circuit's holding must be read in the context of the relevant statute upon which the prisoner's claim was based. This statute provided that the interest and income earned on the money in the prisoner's trust fund must be credited to that fund *after* applicable charges were deducted. *Tellis*, 5 F.3d at 1316 (quoting Nev.Rev.Stat. § 209.241). Contrary to the Plaintiffs' argument, *Tellis* simply cannot be read as supporting the broader conclusion that a person has a protected property interest in interest generated from his or her funds, regardless of whether any net interest can ever be realized.

The Plaintiffs also cite the Fifth Circuit's opinion in *Eubanks v. McCotter*, 802 F.2d 790 (5th Cir.1986), another case in which prisoners sued prison officials alleging that their failure to pay the prisoners the interest generated by pooled inmate trust funds constituted a taking. The Fifth Circuit reversed the lower court, which had dismissed *sua sponte* the claim as frivolous. The Fifth Circuit found that the prisoners' claims were "not wholly insubstantial or frivolous" and were "minimally sufficient to require a decision on the merits." *Eubanks*, 802 F.2d at 793-94. This, however, is the limit of the extent to which the Fifth Circuit recognized or endorsed the viability of these claims. See *Id.* at 794. Thus, *Eubanks* applicability to the Plaintiffs' position is tenuous at best.

In scrutinizing the holdings and the underlying facts of both *Tellis* and *Eubanks*, it may be concluded that the prisoners were recognized to have property interests in the interest generated by their inmate trust accounts, but only after applicable charges were deducted. Accordingly, the Court finds that these cases, like *Webb's* and *Sellers* are inapposite.

*Fifth Amendment Protection of Plaintiffs'
Expectation Interest*

The Plaintiffs alternately argue that, even if they lack a protected property interest in the generated interest, they have a protected property right to exclude others from the beneficial use of their funds while they are deposited in IOLTA accounts. In support of this purported right, the Plaintiffs rely primarily upon cases standing for the proposition that property owners may exclude others from their real, or tangible property. *See, e.g., Dolan v. City of Tigard*, — U.S. —, 114 S.Ct. 2309, 129 L.Ed.2d 304 (1994) (government requirement that property owner dedicate portion of property within flood plain for public improvements contrary to Fifth Amendment); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 102 S.Ct. 3164, 73 L.Ed.2d 868 (1982) (government regulation requiring private property owners to allow conduits for cable television to be attached even when property owners were not cable subscribers was an unconstitutional taking without just compensation); *Kaiser Aetna v. United States*, 444 U.S. 164, 100 S.Ct. 383, 62 L.Ed.2d 332 (1979) (federal government's imposition of a navigational servitude on owners of a private marina requiring that they allow a right of access to the public amounted to an unconstitutional taking). But, as noted, these cases all involve governmental intrusions or interference with real or tangible property. These cases do not recognize a similarly protected property right to control or exclude others from intangible property, and therefore are insufficient to support a finding

that the Plaintiffs have a protectable property interest in the beneficial use of IOLTA-eligible funds.¹²

The Plaintiffs do correctly note that there are certain "intangible rights" that merit Fifth Amendment protection. *See, e.g., Lynch v. United States* 292 U.S. 571, 54 S.Ct. 840, 78 L.Ed. 1434 (1934) (valid contracts are property which cannot be taken without just compensation); *James v. Campbell*, 104 U.S. 356, 26 L.Ed. 786 (1881) (patents entitled to Fifth Amendment protection). However, inherent in these types of property is the necessity of excluding others to preserve the property interest. Accordingly, these cases fail to support the Plaintiffs' proffered analogy. *See Washington Legal Foundation*, 993 F.2d at 974 n. 10 ("[W]e do not find analogous, intangible property rights which, by their nature or by agreement, require the exclusion of others to preserve the property interest").

To preclude summary judgment on the Plaintiffs' Fifth Amendment claims, the Court would have to find a genuine issue of material fact as to the operation of the IOLTA Program, the nature of the Plaintiffs property interest in interest generated by funds placed in IOLTA accounts, or the effect of the IOLTA Program on the generated interest. The Court finds that there is no factual dispute as to these issues, but only as to the characterizations of the client's property interests, all questions of law. Having resolved these questions in favor of the Defendants, the Court finds that the Plaintiffs' Fifth Amendment claims should be dismissed.¹³

¹² *See Washington Legal Foundation*, 993 F.2d at 974.

¹³ The conclusion that the Texas IOLTA Program does not violate the Fifth Amendment is consistent with the holdings of numerous other decisions from other jurisdictions. *See, e.g., Cone, supra; Washington Legal Foundation, supra; In re Interest on Trust Accounts*, 402 So.2d 389 (Fla.1981); *Petition of Minnesota State Bar Association*, 332 N.W.2d 151 (Minn.1982); *Petition of New Hampshire Bar Association*, 122 N.H. 971, 453 A.2d 1258 (1982);

PLAINTIFFS' FIRST AMENDMENT CLAIMS

The Plaintiffs further claim that the collection and use of interest generated from funds clients place with their attorneys under the Texas IOLTA Program deprive the clients of their rights of freedom of speech and association guaranteed by the First Amendment.¹⁴

"It is well-established that the freedom of speech protected by the First Amendment includes the freedom to choose 'both what to say and what *not* to say.'" *Hays County Guardian v. Supple*, 969 F.2d 111, 123 (5th Cir. 1992), *cert. denied* — U.S. —, 113 S.Ct. 1067, 122 L.Ed.2d 371 (1993) (quoting *Riley v. National Federation for the Blind*, 487 U.S. 781, 797, 108 S.Ct. 2667, 2677, 101 L.Ed.2d 669 (1988)) (emphasis in original). The right to refrain from speech is violated when the government compels an individual to endorse a belief that he or she finds repugnant. *Id.* (citations omitted). It also may be violated when the government compels an individual to subsidize political and ideological purposes with which he or she disagrees. *Id.* (citing *Lyng v. Int'l Union, United Auto Workers*, 485 U.S. 360, 369, 108 S.Ct. 1184, 1191, 99 L.Ed.2d 380 (1988)); *Chicago Teachers Union Local No. 1 v. Hudson*, 475 U.S. 292, 301, 106

In re Interest on Lawyers Trust Accounts, 672 P.2d 406 (Utah 1983); *In re Interest on Lawyers Trust Accounts* 283 Ark. 252, 675 S.W.2d 355 (1984); *Petition of Massachusetts Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985); *Carroll v. State Bar of California*, 166 Cal.App.3d 1193, 213 Cal.Rptr. 305 (4th Dist.), *cert. denied sub nom. Chapman v. State Bar of California*, 474 U.S. 848, 106 S.Ct. 142, 88 L.Ed.2d 118 (1985).

¹⁴ The First Amendment provides: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people to peaceably assemble, and to petition the Government for a redress of grievances." U.S. Const. amend. I. The Fourteenth Amendment makes this limitation applicable to the States and to its subdivisions. See *Gitlow v. New York*, 268 U.S. 652, 45 S.Ct. 625, 69 L.Ed. 1138 (1925) and *Lovell v. Griffin*, 303 U.S. 444, 58 S.Ct. 666, 82 L.Ed. 949 (1938).

S.Ct. 1066, 1073, 89 L.Ed.2d 232 (1986); *Aboud v. Detroit Bd. of Educ.*, 431 U.S. 209, 234-35, 97 S.Ct. 1782, 1799, 52 L.Ed.2d 261 (1977).

Essentially, the Plaintiffs claim that their mandatory participation in the IOLTA Program forces clients to financially support, and thereby associate with, various recipient organizations whose purported objectives the Plaintiffs find objectionable.¹⁵ However, at least as far as the client is concerned, such a claim is necessarily predicated upon the Plaintiffs' claim that the funds generated from the IOLTA accounts are, in fact, the property of the client. As determined in the preceding discussion regarding the Plaintiffs Fifth Amendment claims, the interest generated by the IOLTA program is not the property of any of the Plaintiffs, thus, the collection and use of the interest by the IOLTA program does not constitute financial support by the Plaintiffs of the recipient organizations.

Furthermore, the IOLTA Program in no way compels any of the Plaintiffs to actually associate or otherwise be linked with the recipient organizations that they find repugnant (e.g., by becoming members or being publicly listed as benefactors). Because the Plaintiffs have failed to adequately allege any connection between themselves and the IOLTA recipient organizations, the Court finds that the Texas IOLTA Program does not unconstitu-

¹⁵ As noted *supra*, IOLTA Rules prohibit recipient organizations from using grants to fund lobbying or certain types of litigation. These limitations do not lead the Court to conclude that First Amendment issues have not been raised, despite the Defendants' contentions. Admittedly the collection and disbursement of funds appears to lack a First Amendment dimension. However, it is not disputed that the funds collected through IOLTA are awarded to meet the otherwise unmet needs for legal service of indigent Texans. The Supreme Court has recognized the expressive nature of litigation within the context of the First Amendment. See *Lehnert v. Ferris Faculty Ass'n*, 500 U.S. 507, 111 S.Ct. 1950, 114 L.Ed.2d 572 (1991). Accordingly, the Court finds that there is expressive activity sufficient to invoke the First Amendment.

tionally burden the Plaintiffs' First Amendment rights. See *Washington Legal Foundation*, 993 F.2d at 980. Compare *Carroll v. Blinken*, 957 F.2d 991 (2d Cir.), cert. denied, — U.S. —, 113 S.Ct. 300, 121 L.Ed.2d 224 (1992) (compulsory student fees used to support statewide student advocacy organization, which automatically made all students members, impermissibly forced association in violation of the First Amendment).

The Plaintiffs also appear to contend that, even absent any financial link to the IOLTA Program, the mandatory Program forces attorneys to be associated with the TEAJF and its recipient organizations. It arguably could be said that the mandatory IOLTA Program forces attorneys to associate with these groups (albeit in an attenuated fashion). However, even if this were true, such compelled association does not give rise to a constitutional violation. In *Keller v. State Bar of California*, 496 U.S. 1, 110 S.Ct. 2228, 110 L.Ed.2d 1 (1990), the Supreme Court considered a challenge brought by California attorneys regarding the use of the state bar's dues to finance certain ideological or political activities. The Court held that the bar's use of compulsory dues to finance activities having "political or ideological coloration" violated the First Amendment, *except* when such expenditures were reasonably or necessarily incurred for the purpose of regulating the legal profession or improving the quality of legal services available to the people of the state. *Keller*, 496 U.S. at 14, 110 S.Ct. at 2236; see also *Lathrop v. Donohue*, 367 U.S. 820, 843, 81 S.Ct. 1826, 1838, 6 L.Ed.2d 1191 (1961). The undisputed purpose of the IOLTA Program is to provide funding for legal services to a substantial segment of the population of Texas. This squarely fits within the purview of improving the quality of the legal service available to the people of the state as contemplated by *Keller*. Furthermore, the extent of an attorney's involvement with the IOLTA Program is merely handling his client's funds in a slightly different fashion than he would otherwise. There is no contribution of the

attorney's own funds or his or her bar dues. Accordingly, the Court finds no constitutional infirmity with respect to attorneys' mandatory participation in the IOLTA Program.

Because the Court does not find that the IOLTA Program adversely impacts the Plaintiffs' rights either under the First or Fifth Amendment, the Court will not delve into extended First Amendment analysis regarding whether the Program is adequately tailored to serve the state's claimed interest. It suffices to say that providing indigent Texans with the means to gain access to the legal system is a significant state interest and the operation of the system imposes minimal burdens upon First Amendment rights of attorneys and their clients. See, generally, *Hays County Guardian v. Supple*, 969 F.2d at 122-24.

ELEVENTH AMENDMENT AND 42 U.S.C. § 1983 IMMUNITY

The Defendants also argue that they are entitled to Eleventh Amendment immunity and that they are not "persons" for purposes of 42 U.S.C. § 1983.

Eleventh Amendment Immunity

The Eleventh Amendment generally divests federal courts of jurisdiction to entertain suits directed against states. *Green v. State Bar of Texas*, 27 F.3d 1083, 1087 (5th Cir.1994) (citing *Port Auth. Trans-Hudson Corp. v. Feeney*, 495 U.S. 299, 304, 110 S.Ct. 1868, 1971, 109 L.Ed.2d 264 (1990)). Unless consent is given, the Eleventh Amendment forbids suit against a state, a state agency or department of the state by citizens of the state. *Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89, 100, 104 S.Ct. 900, 907, 79 L.Ed.2d 67 (1984). Suit is barred against a state entity regardless of whether money damages or injunctive relief is sought. *Clark v. Tarrant County, Texas*, 798 F.2d 736, 743 (5th Cir. 1986); *Krempp v. Dobbs*, 775 F.2d 1319, 1321 (5th

Cir.1985); *Cory v. White*, 457 U.S. 85, 102 S.Ct. 2325, 72 L.Ed.2d 694 (1982).

In a suit challenging a rule of a state supreme court, the supreme court is the real party in interest if it has the ultimate authority to adopt and enforce the rule in question. *Lewis v. Louisiana State Bar Ass'n*, 792 F.2d 493, 497 (5th Cir.1986). In such an instance, moreover, an entity whose role is completely defined by the state supreme court, which acts as the agent of the court, occupies the position of a public agency for purposes of Eleventh Amendment analysis. See *Lewis v. Louisiana State Bar Ass'n*, 792 F.2d 493 (5th Cir.1986) (Louisiana Supreme Court and state bar association both entitled to Eleventh Amendment immunity from action by unsuccessful bar applicant's due process complaint); accord *Krempp v. Dobbs*, 775 F.2d at 1321. (Suit against Texas State Bar and State Commission on Judicial Conduct barred by Eleventh Amendment).

As noted above, the TEAJF was created by an order of the Texas Supreme Court in 1988, pursuant to the court's inherent power to regulate the practice of law in Texas. Pursuant to that order, the TEAJF has statewide authority to act and carries out its objectives on a statewide basis. Consistent with the logic of *Lewis*, the Court finds that the TEAJF is an arm of the Texas Supreme Court, and consequently the State of Texas, thereby entitling the TEAJF to Eleventh Amendment protection from all of the Plaintiffs' claims.

However, the Eleventh Amendment does not bar suits for injunctive relief against state officials. *Word of Faith World Outreach Ctr. v. Morales*, 986 F.2d 962, 965 (5th Cir.), cert. denied, — U.S. —, 114 S.Ct. 82 126 L.Ed.2d 50 (1993); *Ex Parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908). Accordingly, to the extent that the Plaintiffs' complaint seeks injunctive relief against the Chairman of the TEAJF, such claims are permitted under the Eleventh Amendment.

42 U.S.C. § 1983

A state official acting in his official capacity is not a person under § 1983 unless the relief requested in a suit against him in this capacity is prospective relief. *John G. and Marie Stella Kenedy Mem. Found. v. Mauro*, 21 F.3d 667, 671 (5th Cir.), cert. denied, — U.S. —, 115 S.Ct. 577, 130 L.Ed.2d 493 (1994); *Will v. Michigan Dep't of State Police*, 491 U.S. 58, 71 & n. 10, 109 S.Ct. 2304, 2312 & n. 10, 105 L.Ed.2d 45 (1989). Accordingly, to the extent the Plaintiffs seek prospective relief against the Chairman of the TEAJF, Dean Frank Newton, such claims may proceed; however, any monetary relief is barred.¹⁶

CONCLUSION

The Court declines to address the expressed social, political or public policy concerns related to the current operational procedures of the Texas Equal Access to Justice Foundation as it administers the IOLTA Program. Alleviation of these concerns rests with Texas attorneys and their relationship to the state bar, as well as the care of all Texas voters in the selection of their elected public officials.

Based upon the foregoing analysis, the Court finds that the Defendants' Motions for Summary Judgment should be granted, and the Plaintiffs' claims should be dismissed in their entirety. Further, the Court finds that the Plaintiffs' Motion for Summary Judgment should be denied.

THEREFORE, IT IS ORDERED that the Motion for Summary Judgment, filed by the Texas Equal Access to

¹⁶ The parties do not address whether the individual justices of the Texas Supreme Court are entitled to Eleventh Amendment Immunity or are persons for § 1983 purposes. However, the Court finds that were these issues before it, the same analysis would apply—i.e., the Plaintiffs' claims for injunctive remedies may be sought against the individual Justices.

Justice Foundation on December 6, 1994, is hereby GRANTED.

FURTHER, IT IS ORDERED that the Motion for Summary Judgment, filed by the Supreme Court Defendants on December 6, 1994, is hereby GRANTED.

FURTHER IT IS ORDERED that the Motion for Summary Judgment, filed by the Plaintiffs on December 8, 1994 is hereby DENIED.

ACCORDINGLY, IT IS ORDERED, ADJUDGED AND DECREED that any and all claims brought by the Plaintiffs against the Defendants in the above-numbered and styled cause of action are hereby DISMISSED WITH PREJUDICE.

FURTHER, IT IS ORDERED, ADJUDGED AND DECREED that the above-numbered and styled cause of action is hereby DISMISSED WITH PREJUDICE.

FINALLY, IT IS ORDERED that Clerk shall TERMINATE AS MOOT any motions that remain pending in this action.

APPENDIX C

UNITED STATES COURT OF APPEALS FIFTH CIRCUIT

No. 95-50160

WASHINGTON LEGAL FOUNDATION;
WILLIAM R. SUMMERS; MICHAEL J. MAZZONE,
Plaintiffs-Appellants,

v.

TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION; W.
FRANK NEWTON, Chairman, Texas Equal Access to
Justice Foundation; THOMAS R. PHILLIPS, Chief Jus-
tice; RAUL GONZALEZ, Justice; JACK HIGHTOWER,
Justice; NATHAN L. HECHT, Justice; LLOYD A. DOG-
GETT, Justice; BOB GAMMAGE, Justice; CRAIG T.
ENOCH, Justice; JOHN CORNYN, Justice; ROSE SPECTOR,
Justice; SUPREME COURT DFTS,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Texas
James R. Nowlin, Judge

Feb. 14, 1997

ON PETITIONS FOR REHEARING AND SUGGESTIONS FOR REHEARING EN BANC

Before WISDOM, GARWOOD and JONES, Circuit Judges.

PER CURIAM:

A member of the court in active service having requested a poll on the reconsiderations of this cause en banc, and a majority of the judges in active service not having voted in favor, Rehearings En Banc are DENIED.

POLITZ, Chief Judge, and KING, WIENER, BENAVIDES, STEWART and PARKER, Circuit Judges, dissent from the refusal of the court to grant rehearing en banc.

BENAVIDES, Circuit Judge, joined by POLITZ, Chief Judge, and STEWART and PARKER, Circuit Judges, dissenting from failure to grant rehearing en banc:

In the subject case, a panel of this court held that "clients . . . have a cognizable property interest in the interest proceeds that are earned on their deposit in IOLTA accounts." 94 F.3d 996, 1005 (5th Cir.1996). In reaching this conclusion, the panel relied upon the traditional rule applied in Texas that "interest follows principal," which recognizes that interest earned on a deposit belongs to the owner of the principal. *Id.* at 1000. The panel also relied upon the Supreme Court's opinion in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, which in turn relied upon the same state law rule to hold that "earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Id.* at 1002 (quoting 449 U.S. 155, 164, 101 S.Ct. 446, 452-53, 66 L.Ed.2d 358 (1980)).

This decision is an important one because it contradicts every other court in the country that has addressed this issue, including two of our sister circuits and a large num-

ber of state appellate courts.¹ Moreover, while purporting to resolve only a threshold issue in this case, the opinion is bound to create difficulties and confusion for the district court on remand. Finally, this case poses an unwarranted threat to a primary source of funding for public interest legal organizations in this circuit at a time when these organizations are already struggling for their lives financially. For the foregoing reasons, I believe that this case is worthy of our en banc consideration and respectfully dissent from the contrary conclusion of my colleagues.

I.

Texas is one of fifty states that operates an Interest on Lawyers Trust Account Program ("IOLTA"). The IOLTA concept is possible because there are situations in which the costs of maintaining funds held by lawyers for their clients exceed the interest that a client can earn from a financial institution. When the amount of a client's funds to be held is nominal or when a client's funds will be held for a brief period of time, the deposit of a client's funds acts as an interest-free loan to the bank. IOLTA is an attempt to transfer this benefit from banks to legal providers for the indigent. The Texas IOLTA program has been a resounding success, raising approximately \$10 million per year for legal services organizations in the state.

¹ See *Washington Legal Fdn. v. Mass. Bar Fdn.*, 993 F.2d 962 (1st Cir.1993); *Cone v. State Bar of Fla.*, 819 F.2d 1002 (11th Cir.), *cert. denied*, 484 U.S. 917, 108 S.Ct. 268, 98 L.Ed.2d 225 (1987); *Carroll v. State Bar of Cal.*, 166 Cal.App.3d 1193, 213 Cal.Rptr. 305 (Cal.Ct.App.1984), *cert. denied*, 474 U.S. 848, 106 S.Ct. 142, 88 L.Ed.2d 118 (1985); *Petition by Mass. Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1975); *In re Interest on Lawyers' Trust Accounts*, 279 Ark. 84, 648 S.W.2d 480 (1983); *In re Adoption of Amendments to C.P.R.D.R. 9-102 IOLTA*, 102 Wash.2d 1101 (Wash. 1984); *In re Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *In re New Hampshire Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258 (1982); *In re Minnesota State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla.1981).

The plaintiffs brought this action because of their objections to the activities of the recipients of IOLTA funds.² *Washington Legal Fdn.*, 94 F.3d at 999. The plaintiffs contend that the IOLTA program constitutes an unconstitutional taking of property, in violation of the Fifth Amendment to the United States Constitution, and that the program violates the First Amendment because it forces them to support speech they find offensive. The plaintiffs seek an injunction against further operation of the Texas IOLTA program and compensation for any interest earned on their deposits into IOLTA accounts.

The district court concluded that the plaintiffs' constitutional challenges failed at the threshold because the plaintiffs could not establish a property interest in the earnings from funds deposited in IOLTA accounts. The district court, therefore, granted summary judgment in favor of the defendants. On appeal, a panel of this court reversed the decision of the district court and remanded the case for further proceedings.

II.

"The pertinent words of the Fifth Amendment of the Constitution of the United States are the familiar ones: 'nor shall private property be taken for public use, without just compensation.'" *Webb's Fabulous Pharmacies*, 449 U.S. at 160, 101 S.Ct. at 450. In order to prevail on a takings clause claim, a plaintiff must establish an interest in private property. "Property interests . . . are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or under-

² IOLTA rules provide that "[t]he Foundation shall make grants to organizations . . . hav[ing] as a primary purpose the delivery of legal services to low income persons. . . ." TEXAS RULES OF COURT-STATE, Rules Governing the Operation of the Texas Equal Access to Justice Foundation ("IOLTA Rule"), Rule 10 (West 1996). Eligible recipient organization "shall use such funds to provide legal services to individual indigent persons." IOLTA Rule 11.

standings that stem from an independent source such as state law." *Board of Regents v. Roth*, 408 U.S. 564, 577, 92 S.Ct. 2701, 2709, 33 L.Ed.2d 548 (1972). "But a mere unilateral expectation or an abstract need is not a property interest entitled to protection." *Webb's Fabulous Pharmacies*, 449 U.S. at 161, 101 S.Ct. at 451.

At the outset, it is important to draw a distinction never addressed by the panel between "accrued interest" and "interest proceeds." The panel correctly noted that accrued interest is always created by funds deposited in a bank. *See Washington Legal Fdn.*, 94 F.3d at 1003. The IOLTA concept is simply an attempt to transfer this accrued interest from banks to legal aid organizations. Interest proceeds, however, are the amount of accrued interest that remains after deducting the costs of administering a deposited fund. It is undisputed that a client's funds may be deposited in an IOLTA account only if they are incapable of producing interest proceeds because of the nominal amount or the short duration of the deposit.³

³ IOLTA Rule 6 provides, in part:

The funds of a particular client are nominal in amount or held for a short period of time, and thus eligible for use in the Program, if such funds, considered without regard to funds of other clients which may be held by the attorney, . . . could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client.

It is worth noting that whether attorneys correctly apply the requirements of Rule 6 is irrelevant to the constitutional issue resolved by the panel's opinion. If attorneys violate IOLTA's rules by depositing ineligible funds, it seems that any action a client might have would be against her attorney. To the extent the state may be implicated, this is certainly not because IOLTA's rules result in the taking of a client's property, but rather because IOLTA's rules were not followed.

A careful reading of *Webb's* makes clear that the existence of interest proceeds to which the depositors were entitled was a prerequisite to the Court's decision. In reaching its conclusion that creditors had a cognizable property right to the interest from an interpleader fund deposited with the court clerk for their benefit, the Court held that "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Webb's Fabulous Pharmacies*, 449 U.S. at 164, 101 S.Ct. at 452 (emphasis added). A clear implication of this holding is that if a fund generates no earnings to which its owner is entitled, there is no cognizable property interest.

Moreover, when the Court discussed whether the creditors had a property interest in the principal of the interpleader fund, the Court recognized that "[i]t is true, of course, that none of the creditor claimants had any right to the deposited fund until their claims were recognized and distribution was ordered." *Id.* at 161, 101 S.Ct. at 451 (citation omitted). In concluding that the creditors did in fact have a property interest, the Court was careful to note that "[e]ventually, and inevitably, that fund, less proper charges authorized by the court, would be distributed among the creditors as their claims were recognized by the court." *Id.* This language makes clear that the Court will not recognize a constitutionally cognizable interest in the principal of a deposited fund unless and until it is clear that the funds will be distributed as proceeds to its beneficiary. Therefore, when the Court later concluded that earnings from such a fund are property "just as the fund itself is property," *id.* at 164, 101 S.Ct. at 452, the Court strongly suggested that interest proceeds are a necessary prerequisite to a constitutionally cognizable property interest in the earnings from a deposited fund.

Finally, the Court was careful to limit its holding to cases in which a separate statute authorizes the state to subtract its administrative costs. *See id.* at 164-65, 101

S.Ct. at 452-53. In those cases it is clear that interest proceeds exist because the costs of administering the fund have already been subtracted from the accrued interest generated by the fund. Therefore, it is equally clear that the fund's owner has been deprived of a property interest. In cases where "double tolling" of this sort does not occur, it cannot be so easily determined whether the fund's owner has been deprived of interest proceeds to which she is entitled. It is clear to me that the Court limited its holding because a bright-line rule establishing a property interest in this latter situation would be inappropriate.

Similarly, it follows that the state law rule that "interest follows principal" controls only when interest is earned on the principal or, in other words, when interest proceeds are available.⁴ Consider the fate of the plaintiffs' accrued interest in the absence of IOLTA. Because the costs of administering the deposited funds would exceed any interest earned by a client, the bank would keep the accrued interest. Are the banks violating the traditional state law rule? Are the banks somehow converting or stealing the clients' property? The answer of course is no—because the clients had no interest in property to take.

III.

The panel attempted to avoid this reality by claiming that a bank assigns interest to a depositor in a two-part process. *See Washington Legal Fdn.*, 94 F.3d at 1003. According to the panel, a bank attributes interest to an account prior to deducting any of its fees. *Id.* From this, the court concluded that "a property interest attaches the moment that the interest accrues . . ." *Id.*

Even if the panel presents an accurate picture of banking practices, however, those practices are beside the point.

⁴ The *Webb's* Court's limitation of its holding would have been unnecessary if the "interest follows principal" rule results in the creation of a property interest irrespective of the costs associated with administering accrued interest.

For purposes of a takings clause challenge, a constitutionally cognizable interest in property does not exist in "earnings" from a deposited fund unless and until those earnings can be distributed as proceeds to the fund's beneficiary. Because IOLTA-eligible funds would never produce interest proceeds, earnings from such funds cannot be distributed to the funds' owners. For this reason, the panel's conclusion that a property interest was created after the first step in the bank's process of assigning interest is simply wrong.

The fact that interest proceeds are created by the Texas IOLTA program does not weaken this conclusion. Rather, the simple recognition that without IOLTA there would be no interest proceeds compels it. The plaintiffs in this case are not harmed in any way by the existence of IOLTA and would not be benefitted in any tangible way by its elimination. I find it both ironic and fatal to the plaintiffs' claim that in order to have a property interest in this case, they must rely on the existence of the program they seek to eliminate.

In addition to being consistent with a fair interpretation of the legal authority relied upon by the panel, rejection of the plaintiffs' asserted property interest in this case is consistent with the protections underlying the Takings Clause. The Takings Clause provides that "private property [shall not] be taken for public use, without just compensation." U.S. CONST. amend. V. While beneficial use of property is certainly not essential to the existence of a property interest worthy of the protections of this provision, such an interest does require that the property at issue have some actual or potential *compensable* value that could accrue to the benefit of its owner. In addition, a primary purpose of the Takings Clause is to protect the investment-backed expectations of property owners that their property will not be taken for public use without just compensation.⁵

⁵ In *Lucas v. South Carolina Coastal Council*, Justice Scalia noted that the Court has "acknowledged time and again, '[t]he eco-

Unless the owner of a fund deposited in an IOLTA account could reasonably expect to receive interest proceeds (of any amount) from her earnings, the client's "property" does not have any compensable value. Moreover, the fact that the client does not receive any interest proceeds from her deposited funds does not interfere with her investment-backed expectations because she could not have reasonably expected to receive any net interest when the deposit was made. In my view, these unusual circumstances prevent the client from asserting a constitutionally cognizable interest in property.

This understanding of the Takings Clause is buttressed by the available remedy for plaintiffs whose property has been unconstitutionally taken. Such plaintiffs are entitled to just compensation, i.e., the fair market value of their property. Because the fair market value of the earnings of IOLTA-eligible funds is \$0, the client would be entitled to nothing. In sum, applying Fifth Amendment protections to an asserted property interest that does not have any compensable value is not consistent with the purposes that underlie the Takings Clause—to compensate a property owner for the value of her property that was taken for public use.

IV.

In addition to creating a circuit split, misinterpreting the legal authority upon which it relied, and applying a takings clause analysis to governmental action that does not implicate relevant Fifth Amendment values, the panel's analysis can only create confusion for the district court on remand. The Supreme Court's cases dealing with the Tak-

conomic impact of the regulation on the claimant and . . . the extent to which the regulation has interfered with distinct investment-backed expectations' are keenly relevant to takings analysis generally." 505 U.S. 1003, 1019 n. 8, 112 S.Ct. 2886, 2895 n. 8, 120 L.Ed.2d 798 (1992) (quoting *Pennsylvania Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 124, 98 S.Ct. 2646, 2659, 57 L.Ed.2d 631 (1978)).

ings Clause fit roughly into the two categories of regulatory takings and per se takings. See JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW § 11.12, at 462-66 (5th ed. 1995). Regulatory takings involve governmental regulations that impinge upon a property owner's economic interests. In regulatory takings cases, the Court has adopted a balancing test whereby it weighs the economic impact of the regulation on the property owner suffering the loss against the public benefits of the regulation. See, e.g., *Pennsylvania Cent. Transp. Co.*, 438 U.S. at 124, 98 S.Ct. at 2659. Viewed as a regulatory takings case, IOLTA clearly passes muster because the clients have suffered no economic loss and the public has greatly benefitted. See *Massachusetts Bar Fdn.*, 993 F.2d at 976 (noting that Massachusetts's IOLTA program has no economic impact on clients and does not interfere with their investment-backed expectations).

Per se takings involve what might be considered a "literal" taking of property. The Court adopts a per se approach and finds a compensable taking of property without a case-by-case inquiry. See NOWAK & ROTUNDA, *supra*, § 11.12, at 463-64. The Court has adopted a per se approach if a regulation deprives an owner of the entire value of her property. *Id.* (citing *Lucas*, 505 U.S. at 1003, 112 S.Ct. at 2886). The Court has also adopted a per se approach if the governmental action results in physical occupation of property or a permanent change in rights of ownership. *Id.* at 464 (citing *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 102 S.Ct. 3164, 73 L.Ed.2d 868 (1982)). Viewed as a per se takings case whereby the clients have a property interest that is literally appropriated by the state, IOLTA is almost certainly unconstitutional.

Webb's was clearly a per se takings case. The Court's entire opinion is dedicated to determining that the creditors had a property right in the principal and interest proceeds of the subject interpleader fund. See 449 U.S. at

156-64, 101 S.Ct. at 448-53. Because this property was appropriated by the state for its own purposes, a literal taking of the property occurred. This latter conclusion required no separate analysis by the Court and accordingly was given none. See *id.* at 164-65, 101 S.Ct. at 452-53.

The panel's opinion in the instant case gave no explicit indication whether the court viewed the case as a regulatory or per se takings case. If the panel viewed this case as one involving a regulatory taking, it should have made this clear in its remand order and should not have relied on *Webb's*. On the other hand, if the panel regarded the case as one involving a per se taking, it should not have bifurcated the inquiries regarding whether the clients had a property right and whether a taking of that property occurred. An affirmative answer to the second question would necessarily follow from an affirmative answer to the first.

The panel's opinion implicitly indicated that it left open the question of whether the case should be viewed as a regulatory takings case or as a per se takings case. The panel noted that "to prevail on their taking claim, the plaintiffs must demonstrate that the taking was against the will of the property owner." *Washington Legal Fdn.*, 94 F.3d at 1004. In addition, the court cited *Yee v. City of Escondido*, 503 U.S. 519, 539, 112 S.Ct. 1522, 1534-35, 118 L.Ed.2d 153 (1992), which held that "because [a city's] rent control ordinance [did] not compel a landowner to suffer the physical occupation of his property, it [did] not effect a per se taking" While the applicability of this decision to the context of deposited funds is not clear, it does leave open the possibility that a per se taking did not occur in the subject case because clients voluntarily deposit their money with an attorney (who, in turn, deposits eligible funds into an IOLTA account). The fact remains, however, that *Webb's*, the principal case relied upon by the panel, was a per se takings case. Be-

cause I abide by my concerns regarding the panel's conclusion that the plaintiffs asserted a constitutionally cognizable property interest in the accrued interest from IOLTA deposits, I would not burden the district court with this confusion.

V.

The issue addressed by the panel in the subject case raises very difficult and interesting conceptual issues regarding the proper definition of property for Fifth Amendment purposes. Three judges in this circuit have concluded that the plaintiffs have asserted a constitutionally cognizable property interest in the earnings from IOLTA-eligible funds, despite the inability of such funds to produce interest proceeds. I disagree with that conclusion, as has every other court to have addressed the issue. Moreover, the panel's decision on this "threshold issue" will have important implications for the disposition of this case on remand and, ultimately, for the constitutionality of the IOLTA programs in Louisiana, Mississippi, and Texas. For these reasons, I believe that the intellectual efforts of our court's entire membership would have benefitted the decision making process in this clearly important case. I regret my colleagues' decision to deny rehearing en banc and respectfully dissent.

APPENDIX D

CONSTITUTIONAL PROVISIONS AND
FEDERAL STATUTE INVOLVED

**AMENDMENT I—FREEDOM OF RELIGION,
SPEECH AND PRESS; PEACEFUL ASSEMBLAGE;
PETITION OF GRIEVANCES**

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

**AMENDMENT V—GRAND JURY INDICTMENT
FOR CAPITAL CRIMES; DOUBLE JEOPARDY;
SELF-INCRIMINATION; DUE PROCESS OF
LAW; JUST COMPENSATION FOR PROPERTY**

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

12 U.S.C. § 1832 Withdrawals by negotiable or transferable instruments for transfers to third parties

(a) Authority of depository institution; applicability

(1) Notwithstanding any other provision of law but subject to paragraph (2), a depository institution is authorized to permit the owner of a deposit or account on

which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties.

(2) Paragraph (1) shall apply only with respect to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, political, or other similar purposes and which is not operated for profit, and with respect to deposits of public funds by an officer, employee, or agent of the United States, any State, county, municipality, or political subdivision thereof, the District of Columbia, the Commonwealth of Puerto Rico, American Samoa, Guam, any territory or possession of the United States, or any political subdivision thereof.

(b) Definition

For purposes of this section, the term "depository institution" means—

(1) any insured bank as defined in section 1813 of this title;

(2) any State bank as defined in section 1813 of this title;

(3) any mutual savings bank as defined in section 1813 of this title;

(4) any savings bank as defined in section 1813 of this title;

(5) any insured institution as defined in section 1724 of this title; and

(6) any building and loan association or savings and loan association organized and operated according to the laws of the State in which it is chartered or organized; and, for purposes of this paragraph, the term "State" means any State of the United States, the District of Columbia, any territory of the United

States, Puerto Rico, Guam, American Samoa, or the Virgin Islands.

(c) Fine

Any depository institution which violates this section shall be fined \$1,000 for each violation.

APPENDIX E**EXCERPT FROM TEXAS SUPREME COURT ORDER
ADOPTING STATE BAR RULES ESTABLISHING
TEXAS IOLTA PROGRAM****Article XI****INTEREST EARNED ON CLIENT FUNDS HELD
BY ATTORNEYS****Section 1. Short Title**

This Article may be referred to as the Texas Equal Access to Justice Program.

Section 2. Findings; Purpose

The Supreme Court of Texas finds that:

(A) On certain client funds held by attorneys, interest income cannot reasonably be earned to benefit individual clients for whom the funds are held;

(B) income can be earned on those client funds pursuant to the program provided for in this Article and that income should be used to provide additional legal services to the indigent in civil matters;

(C) this Court is the proper and appropriate body, through the adoption of rules as set forth in this Article, to create and administer, or cause to be created and administered, a program to carry out the purposes of this Article; and

(D) this Article is adopted in furtherance of the inherent powers of this Court to regulate the practice of law in the State of Texas.

APPENDIX F**SELECT TEXAS IOLTA PROGRAM RULES****RULE 4. DEPOSIT OF CERTAIN
CLIENT FUNDS**

An attorney licensed by the Supreme Court of Texas, receiving in the course of the practice of law in this state client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time, must establish and maintain a separate interest-bearing insured depository account at a financial institution and deposit in the account such funds. All client funds may be deposited in a single unsegregated account. Attorneys who practice in a law firm or for a professional corporation may utilize the interest-bearing trust account of such firm or corporation to comply with this Rule 4. The interest earned on the account shall be paid in accordance with and used for the purposes set forth in these Rules. The Foundation shall hold the entire beneficial interest in the interest earned. Funds to be deposited under these Rules shall not include those funds evidenced by a financial institution instrument, such as a draft, until the instrument is fully credited to the financial institution in which the account is maintained. The term "draft" as herein used is defined in Section 3.104(b)(1) of the Texas Business and Commerce Code. A draft or similar instrument need not be treated as a collected item unless it is the type of instrument which the financial institution generally treats as a collected item.

**RULE 6. FUNDS ELIGIBLE
FOR THE PROGRAM**

The funds of a particular client are nominal in amount or held for a short period of time, and thus eligible for use in the Program, if such funds, considered without regard to funds of other clients which may be held by the attorney, law firm or professional corporation, could not

reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client. Also to be considered are the nature of the proceeding or transaction involved and the likelihood of delay in the need for such funds in such proceeding or transaction. The attorney, law firm or professional corporation should exercise good faith judgment in determining initially whether client funds should be included in the Program and should review at reasonable intervals whether changed circumstances require further action with respect to such funds.

RULE 9. DIRECTIONS TO DEPOSITORIES

The depository institution shall be directed by the attorney, law firm or professional corporation establishing the account:

(a) to remit, at least quarterly, interest earned on the average daily balance in the account, less reasonable service charges, to the Foundation;

(b) to transmit to the Foundation with each remittance a statement showing the name of the attorney, law firm or professional corporation with respect to which the remittance is sent, the rate or rates of interest applied, and the amount of service charges deducted, if any; and

(c) to transmit to the depositing attorney, law firm or professional corporation at the same time a report is sent to the Foundation, a report showing the amount paid to the Foundation for that period, the rate or rates of interest applied, the amount of service charges deducted, if any, and the average daily account balance for each month of the period for which the report is made.

APPENDIX G

TEXAS DISCIPLINARY RULES REGARDING MANAGEMENT OF CLIENT FUNDS

**Supreme Court of Texas, State Bar Rules, art. X, § 9
Rule 1.14:**

RULE 1.14 SAFEKEEPING PROPERTY

(a) A lawyer shall hold funds and other property belonging in whole or in part to clients or third persons that are in a lawyer's possession in connection with a representation separate from the lawyer's own property. Such funds shall be kept in a separate account, designated as a "trust" or "escrow" account, maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other client property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation.

(b) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(c) When in the course of representation a lawyer is in possession of funds or other property in which both the lawyer and another person claim interests, the property shall be kept separate by the lawyer until there is an accounting and severance of their interest. All funds in a trust or escrow account shall be disbursed only to those

persons entitled to receive them by virtue of the representation or by law. If a dispute arises concerning their respective interests, the portion in dispute shall be kept separate by the lawyer until the dispute is resolved, and the undisputed portion shall be distributed appropriately.

Supreme Court of Texas, Code of Professional Responsibility, DR 9-102 (Former Rule):

DR 9-102. Preserving Identity of Funds and Property of a Client.

(A) All funds of clients paid to a lawyer or law firm, other than advances for costs and expenses, shall be deposited in one or more identifiable bank accounts maintained in the state in which the law office is situated and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:

(1) Funds reasonably sufficient to pay bank charges may be deposited therein.

(2) Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

(B) A lawyer shall:

(1) Promptly notify a client of the receipt of his funds, securities, or other properties.

(2) Identify and label securities and properties of a client promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable.

(3) Maintain complete records of all funds, securities, and other properties of a client coming

into the possession of the lawyer and render appropriate accounts to his client regarding them.

(4) Promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in the possession of the lawyer which the client is entitled to receive.

MAY 5 1997

CLERK

IN THE
Supreme Court of the United States

OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ, HON.
NATHAN L. HECHT, HON. JOHN CORNYN, HON. CRAIG T.
ENOCH, HON. ROSE SPECTOR, HON. PRISCILLA R. OWEN,
HON. JAMES A. BAKER, HON. GREG ABBOTT, TEXAS EQUAL
ACCESS TO JUSTICE FOUNDATION, AND W. FRANK NEWTON, IN
HIS OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS EQUAL
ACCESS TO JUSTICE FOUNDATION,

Petitioners,

v.

WASHINGTON LEGAL FOUNDATION,
WILLIAM R. SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

**On Petition for a Writ of Certiorari
to the United States Court of Appeals
For the Fifth Circuit**

**RESPONDENTS' MEMORANDUM
IN RESPONSE TO THE PETITION**

MICHAEL J. MAZZONE
9 Greenway Plaza
Suite 2300
Houston, TX 77046
(713) 940-6001
Pro Se

DANIEL J. POPEO
RICHARD A. SAMP
(Counsel of Record)
WASHINGTON LEGAL FOUNDATION
2009 Massachusetts Ave., NW
Washington, DC 20036
(202) 588-0302

DONALD B. AYER
THOMAS M. FISHER
JONES, DAY, REAVIS & POGUE
1450 G St., N.W.
Washington, DC 20005-2088
(202) 879-3939

Date: May 5, 1997

*Attorneys for Respondents WLF and
William R. Summers*

QUESTIONS PRESENTED

1. Is interest earned on client trust funds held in IOLTA accounts a property interest of the client, cognizable under the First and Fifth Amendments to the U.S. Constitution?
2. Is there a federal general common law on which a U.S. Court of Appeals may rest a determination whether interest earned on client trust funds held by lawyers in IOLTA accounts is a property interest cognizable under the First or Fifth Amendments to the U.S. Constitution, rather than following principles of comity and federalism that require deference to determinations of the issue by the highest appellate court of the state?

**PARTIES TO THE PROCEEDINGS
AND RULE 29.6 LIST**

Aside from the parties named in the caption, the following were Defendants/Appellees in the Court of Appeals: Jack Hightower, Lloyd Doggett, and Bob Gammage. They were named as defendants in the complaint, in their official capacities as justices of the Texas Supreme Court. They are no longer members of the Court, having been replaced, respectively, by Greg Abbott, Priscilla R. Owen, and James A. Baker.

Respondent Washington Legal Foundation has no parent company or nonwholly owned subsidiaries to list pursuant to Supreme Court Rule 29.6.

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MEMORANDUM IN RESPONSE TO THE PETITION

The Respondents, Washington Legal Foundation ("WLF"), William R. Summers, and Michael J. Mazzone, respectfully file this memorandum in partial support of Petitioners' prayer that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-captioned case on September 12, 1996. Respondents support granting the writ on Question One, but oppose certiorari on Question Two.

STATEMENT OF THE CASE

Texas, like all other states and the District of Columbia, has established an IOLTA ("Interest On Lawyers' Trust Accounts") program.¹ The Texas IOLTA program generates funds to be used for legal services to indigents by requiring lawyers to deposit nominal client funds and client funds held for a short duration into special IOLTA interest-bearing accounts. As with the IOLTA programs in ~~an~~ other twenty-five states, attorney and client participation in the Texas IOLTA program is mandatory.

More particularly, the IOLTA program requires that client funds must be deposited into an attorney's IOLTA account if they are unable to generate "net interest," that is, interest exceeding the cost of accounting for the funds and bank service charges. *Rules Governing the Operation of the Texas Equal Access to Justice Program*, no. 6. Also, the rules of the Texas IOLTA program specify that "net interest" is to be determined "without regard to funds of other clients which may be held by the attorney." *Id.* Once a lawyer makes a good-faith determination that his client's funds will be unable to generate "net interest" on their own, the lawyer must pool those funds with other nominal

¹ As Petitioners note, Indiana, while it has established a mandatory IOLTA program, has yet to implement its program. The Indiana Supreme Court originally refused to allow an IOLTA program because it viewed participation in such programs as a breach of an attorney's fiduciary duty. *In the Matter of Indiana State Bar Association's Petition To Authorize A Program Governing Interest On Lawyers' Trust Accounts*, 550 N.E.2d 311 (Ind. 1990).

or short term funds that he holds for his other clients in a single IOLTA account. The entire body of interest from these pooled funds is then required to be paid to Petitioner Texas Equal Access to Justice Foundation ("TEAJF"), who distributes the funds earned from IOLTA accounts to a variety of organizations that provide civil legal services to indigents.

The individual Respondents in this case are a lawyer and a client, both of whom are impacted by the Texas IOLTA program and who object to its application to them. Michael J. Mazzone is an attorney licensed to practice law in the State of Texas. Mr. Mazzone maintains an IOLTA account into which he regularly places client trust funds that are either nominal in amount or are reasonably anticipated to be held for a short period of time. Mr. Mazzone has determined from experience that as a practical matter he cannot operate his law practice without collecting client funds that, according to the rules of the Texas IOLTA program, must be placed into an IOLTA account.

William J. Summers is a citizen of Texas who currently has funds being held in an IOLTA account. In December 1992, Mr. Summers was named as a defendant in civil litigation that arose in connection with his business. Mr. Summers agreed to pay his attorney a retainer. However, as part of the agreement, Mr. Summers' attorney bills him periodically for services rendered, rather than drawing on the retainer. It is Mr. Summers's understanding that his attorney would draw against the retainer only if he fails to pay his legal bills in a timely manner. The litigation is ongoing, and Mr. Summers's attorney continues to hold the retainer.

In January 1994, Mr. Summers's attorney informed him for the first time that he had deposited the retainer into his law firm's IOLTA account and that all interest earned on that account is paid to the TEAJF in order to support Texas's IOLTA program. Mr. Summers informed his attorney that he did not want his funds used to support the IOLTA program and thus objected to the placement of his retainer into an IOLTA account. The attorney

responded that, due to the relatively small size of the retainer, he was required by state law to keep the funds in that account.

Respondent WLF is a public interest law firm whose members include Texas lawyers similarly situated to Mr. Mazzone and Texas citizens similarly situated to Mr. Summers.

Because the Texas IOLTA program mandates that attorneys and their clients participate in this method of funding legal services for indigents, Respondents brought this case in district court against the Justices of the Texas Supreme Court, who promulgated the Rules of the Texas IOLTA program; against the TEAJF, which administers the program; and against W. Frank Newton, in his capacity as Chairman of TEAJF, to challenge the constitutionality of the IOLTA scheme.

In the district court, Respondents urged three theories for finding the Texas IOLTA program unconstitutional. First, Respondents argued that any interest earned on client funds sitting in an IOLTA account belongs to the client, regardless of whether those funds could have earned "net interest" on their own. Accordingly, when the Texas IOLTA program appropriates that interest, as it has done with interest earned on Mr. Summers's retainer, it takes the client's property without providing just compensation, in violation of the Takings Clause of the Fifth Amendment.

Second, regardless of who owns the interest generated on client funds deposited into an IOLTA account, the client certainly has a property right in the principal deposit. One of the incidents of ownership of property is the right to exclude others from using it. When the Texas IOLTA program requires clients such as Mr. Summers to deposit funds in an IOLTA account for the benefit of the TEAJF and its beneficiary donees, it deprives those clients of the right to exclude others from using their property. In this way, also, the Texas IOLTA program violates the Takings Clause of the Fifth Amendment.

Finally, Respondents argued before the district court that the Texas IOLTA program compels them to support programs with

which they do not agree. Many of the programs to which the TEAJF distributes money have substantial expressive content. For example, TEAJF's 1991/92 annual report states that in 1992 the TEAJF granted \$100,000 to the Texas Appellate Practice & Educational Resource Center to represent death row inmates seeking to overturn their death sentences through federal habeas corpus actions. And many groups have received grants from the TEAJF to represent undocumented aliens seeking political asylum in order to avoid deportation. Both Mr. Summers and Mr. Mazzone oppose the objectives of some of the litigation activity for which IOLTA funds are earmarked, and thus object to the use of their funds (or, in the case of Mr. Mazzone, the use of his clients' funds) to support those activities. In using interest generated on the principal deposits of Mr. Summers and Mr. Mazzone's clients to support these programs, the Texas IOLTA program compels their financial support of these services, in violation of the First Amendment.

The district court rejected all three of these theories when it denied Respondents' motion for summary judgment and granted Petitioners' motion for summary judgment. Petition Appendix ("Pet. App.") 20a-40a. First, the court ruled that the Respondents have no property right in the interest earned on their IOLTA deposits that is cognizable under the Fifth Amendment. Without the IOLTA program's mandatory pooling of the nominal and short-term client funds, the court held, no interest could be earned on such funds. *Id.* at 30a. Second, Respondents' lack of such property right also defeated their First Amendment claims, according to the district court. Finally, the court ruled that the Respondents could not assert the right to exclusive use of the principal deposits because such exclusive use was not necessary to preserve the property right in the principal. *Id.* at 8.

On appeal, the Fifth Circuit concluded that under the First and Fifth Amendments, clients do maintain a property right in the interest earned on their principal deposits that are pooled into

IOLTA accounts.² Pet. App. 1a-19a. This property right inheres to the owner of the principal regardless of whether "for practical banking reasons, the interest earned in trust accounts could [n]ever accrue to the clients." *Id.* 14a. Accordingly, the court reversed the district court's orders denying Respondents' motion for summary judgment and granting Petitioners' motion for summary judgment, and remanded the case to the district court for further proceedings. The Fifth Circuit subsequently rejected, over a six-member dissent, a Petition for Panel Rehearing and a Suggestion for Rehearing *En Banc*. Pet. App. 41a-52a.

REASONS FOR GRANTING THE WRIT ON QUESTION ONE

Respondents support granting the writ on Question One, but submit that the Fifth Circuit's decision reversing the district court should ultimately be affirmed.

Mandatory IOLTA programs tout their success at deriving something from nothing, at finding money where there was none before. Through this mystical triumph, states have derived a method of funding services, typically legal services for the poor, without, Petitioners insist, forcing anyone to pay for them. The Fifth Circuit compared this apparent success to the art of alchemy. *Id.* at 15a (citing AMERICAN BAR ASS'N, CIVIL JUSTICE: AN AGENDA FOR THE 1990's, 56-72 (1989)). And like

² The Fifth Circuit did not address Respondents' alternative takings argument: whether the Texas IOLTA program deprives clients with deposits in IOLTA accounts of the right to exclude others from benefiting from their property. Thus, contrary to Petitioners' assertion, Pet. 6, if this Court reverses the Fifth Circuit, it should remand the case for further consideration by the Fifth Circuit of Respondents' alternative takings theory. In addition, in the event this Court rejects the proposition that clients have a property right in the interest earned on such deposits regardless of whether they could accumulate that interest absent the IOLTA structure, the lower courts would need to address whether the clients could in fact accumulate interest on short-term and nominal deposits absent the strictures of the IOLTA regulations.

alchemy, of course, the ability of IOLTA plans to create money from nothing to fund legal services for the poor is merely an illusion.

In this case, the Fifth Circuit correctly concluded that the interest earned on funds in IOLTA accounts already belongs to someone--to the clients who own the principal. However, before the Fifth Circuit's decision in this case, the Eleventh and First Circuits had held that clients do not have a property right in the interest earned on their IOLTA deposits. *See, e.g., Cone v. State Bar of Florida*, 819 F.2d 1002, 1006-07 (11th Cir.), *cert. denied*, 484 U.S. 917 (1987); *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962, 979 (1st Cir. 1993).³ Thus, the circuits are in conflict over this issue, which bears directly upon programs established now in every state. Because the conflict is clear, and the issue is likely to recur and is squarely presented by the decision below, respondents agree that this Court should grant review of the first issue.

³ As Petitioners note, Pet. 5, the California Court of Appeal considered this issue in *Carroll v. State Bar of Cal.*, 166 Cal. App. 3d 1193, 213 Cal Rptr. 305 (Cal. Ct. App. 1984), *cert. denied sub nom., Chapman v. State Bar of California*, 474 U.S. 848 (1985). That court upheld California's IOLTA program against constitutional challenge. Petitioner also assert that cases from six other states have held similarly. Pet. 5. However, none of the other cases cited by Petitioners represents an opinion arising from a case or controversy. All of them are non-adversarial advisory opinions supporting the initial creation of IOLTA programs in their respective states.

I. THIS COURT SHOULD RESOLVE THE CONFLICT IN THE CIRCUITS OVER WHETHER THE HOLDING OF THIS COURT IN *WEBB'S FABULOUS PHARMACIES*, EXTENDING CONSTITUTIONAL PROTECTION AGAINST STATE APPROPRIATION OF INTEREST ON INTERPLEADER ACCOUNTS, APPLIES TO INTEREST EARNED ON CLIENTS' FUNDS DEPOSITED INTO IOLTA ACCOUNTS

In *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980), this Court held that "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." On that basis, the Court invalidated the action of a circuit court clerk in appropriating interest on the account, on the ground that such action amounted to an unconstitutional taking from the owners of the principal. The applicability of *Webb's* to the IOLTA context is at the heart of the circuit conflict presented here. In this case, the Fifth Circuit recognized a property right cognizable under the Fifth and First Amendments in the interest earned on their principal deposits in IOLTA accounts. In doing so, it acted in direct contradiction of the Eleventh and First Circuits, which have declined to apply *Webb's* to IOLTA programs and which have concluded that clients do not have a property right to the interest earned on their deposits in IOLTA accounts.

In *Cone v. State Bar of Florida*, 819 F.2d 1002, the Eleventh Circuit passed on the issue whether IOLTA unconstitutionally interfered with the property rights of the clients whose funds were deposited into IOLTA accounts. Though the program examined by the Eleventh Circuit was not mandatory, the court had to decide whether the interest earned on the client's IOLTA deposit was her property. The district court in *Cone* had concluded that a client does not have a protectable property right in the IOLTA interest, and the Eleventh Circuit affirmed. The *Cone* court distinguished *Webb's* because "the interest earned on the . . . funds [at issue in *Webb's*] did give rise to a legitimate claim of entitlement" because the \$90,000 of interest earned on the funds was sufficient to lead to a "legitimate expectation of interest

exclusive of administrative costs and expenses." *Id.* at 1007. However, "the crucial distinction," according to the Eleventh Circuit, was "not the amount of interest earned, but that the circumstances led to a legitimate expectation of interest" *Id.*

In *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962, plaintiffs challenged Massachusetts' mandatory IOLTA program under the First and Fifth Amendments, and the First Circuit focused on the existence of a property right to IOLTA interest as relevant in the First Amendment compulsory speech context.⁴ The court concluded that "[t]he interest generated by funds deposited in IOLTA accounts is not the clients' money." *Id.* at 980. In fact, the court noted, because such interest "belongs to no one, but has been assigned . . . to be used by the IOLTA program," *id.*, the state had not compelled the plaintiffs' financial support for the IOLTA program. *Id.* Further, the First Circuit also distinguished *Webb's* based on plaintiffs' lack of any property right to the interest earned on the IOLTA-deposited funds, citing the *Cone* case in its discussion. *Id.* at 975.

The reasoning of the *Cone* and *Massachusetts Bar Foundation* cases directly conflicts with the decision below. In this case, the Fifth Circuit, applying *Webb's*, concluded that clients have a property interest in the interest earned on their principal funds deposited into IOLTA accounts. The court recognized that Texas follows "the traditional rule that 'interest follows principal,' which recognizes that interest earned on a deposit of principal belongs to the owner of the principal." Pet. App. 8a (citing *Sellers v. Harris Co.*, 483 S.W.2d 242, 243 (Tex. 1972)). Further, this Court had established in *Webb's* "a rule that is independent of the amount or value of the interest at issue, holding that a property interest existed in the accrued interest simply because '[t]he

⁴ The Takings Clause issue was decided solely on the theory that the plaintiffs were denied the exclusive use of their property. *Massachusetts Bar Foundation*, 993 F.2d at 973-76. That issue is not presented to this Court.

earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property.'" *Id.* at 12a (quoting *Webb's*, 449 U.S. at 164). Thus, despite any inability of IOLTA-deposited funds to earn interest in excess of administrative costs, any interest they do earn is the property of the owner of the funds, not the property of the state. Pet. App. 7a.

Accordingly, there is a clear conflict between the First and Eleventh Circuits, on the one hand, and the Fifth Circuit, on the other, over whether interest earned on IOLTA accounts involves a protectable property interest of the owners of the principal. And though a decision by this Court would not result in a final judgment in this case, it would resolve the precise issue on which the circuits are in conflict. The issues remaining in this case are of minimal importance compared to the issue presented here. This court should resolve the dispute.

II. WHETHER IOLTA ACCOUNT INTEREST IS PROTECTED PROPERTY OF THE CLIENTS IS AN IMPORTANT AND RECURRING LEGAL QUESTION

Programs similar to the Texas IOLTA program at issue here are in operation in all but one of the states and the District of Columbia, and the last state, Indiana, is putting one in place at the present time. Thus, on a routine basis, in nearly every jurisdiction in America, lawyers and their clients turn over the interest earned on nominal and short-term client funds to organizations that fund legal services for the poor. As Petitioners note, this pervasive IOLTA movement annually funds legal services for 1.7 million people nationwide (130,000 in Texas alone). Pet. 3. In doing so, IOLTA programs have appropriated as much as \$150 million annually (nearly \$10 million annually in recent years in Texas alone) of interest earned on nominal and short-term client deposits. Henry J. Reske, *IOLTA Dividends In Doubt: Ruling Threatens Program That Distributes Legal Aid Funds From*

Interest On Lawyers' Trust Accounts, ABA JOURNAL, Nov. 1996, at 30.⁵

Furthermore, this issue is not necessarily limited to lawyers and their clients. In view of the amazing ability of IOLTA programs to generate "free" money, the Fifth Circuit was on target in this case when it raised the specter of "incit[ing] a new gold rush, encouraging government agencies to dissect banking regulations to discover other anomalies that lead to 'unclaimed' interest." Pet. App. 15a. The Supreme Court of the State of Washington, for example, has promulgated a program similar to IOLTA for "limited practice officers," that is, nonlawyers who "select, prepare, and complete legal documents incident to the closing of real estate and personal property transactions" Wa. R. Adm. P. 12, 12.1. Such officers must deposit nominal or short-term funds received in connection with closings in a pooled, interest-bearing account, the interest from which is payable to the Legal Foundation of Washington. Wa. R. Adm. P. 12.1 (c)(1). Thus, states are discovering ways to find and capitalize on banking anomalies in other sectors of the economy.

⁵ Currently, the IOLTA programs in about 26 states are mandatory, or "comprehensive," Brennan J. Torregrossa, *Washington Legal Foundation v. Texas Equal Access to Justice Foundation: Is There an IOTA of Property Interest in IOLTA?*, 42 VILL. L. REV. 189, 221 (1997), and that number is likely to grow. As the history of Texas's IOLTA program demonstrates, the greater IOLTA revenues generated by a mandatory program are simply too tempting to forgo. The record in this case shows that the Texas IOLTA program was voluntary for four years, during which time the TEAJF distributed only about \$2.3 million in grants. Since the program became mandatory in 1988, however, the TEAJF has distributed over \$40 million in grants. Moreover, the ABA House of Delegates, no doubt recognizing that great reservoirs of "free" money would remain untapped if IOLTA programs were to remain voluntary, recommended in 1988 that all states with voluntary IOLTA programs should switch to mandatory programs. *Id.*

The Fifth Circuit also noted an additional reservoir of such "unclaimed" interest: the interest credit unions earn on deposited checks during the period before the check clears with the payor bank. Pet. App. 15a-16a. Check deposits generally take one or two days to clear the payor bank, during which time credit unions carry provisional credits for the deposited funds. The depository institution effectively has use of the deposited money during the float period, but credit unions are not required to pay the small amount of interest that would otherwise accrue to the depositor until the check clears. *Id.*; see also, 12 U.S.C. § 4005(b). But that should not mean the float-period interest is free game for the government to absorb.

The more technology speeds the transfer of monetary transactions, the more frequently interest earned during funds transfer and float periods will be measured in pennies or less and "the more and more difficult it will be for individuals to make a practical claim to such funds." Pet. App. 15a. Advances in technology should not mean that such interest belongs to no one. It belongs to the owner of the principal unless, as often happens in the context of bank deposits of clients' short-term and nominal funds, the bank customer chooses to allow the bank to keep the nominal interest in view of the expense of administering and accounting for such sums. See *id.*

This case squarely presents the issue whether interest earned on clients' nominal and short-term deposits into IOLTA accounts belongs to the clients. No further proceedings below could develop facts instructive on this narrow issue. It is a purely legal question, and one that is fundamental to the further conduct of the case. See, e.g., *United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945). Given the great volume of IOLTA transactions at present, and the broad implications and potential applications of the government action authorized in the IOLTA context, review by this Court is necessary.

REASONS FOR DENYING THE WRIT ON QUESTION TWO

Although Question One presented by Petitioners is worthy of this Court's certiorari jurisdiction, Question Two, whether general federal common law governs the case, is not.

I. QUESTION TWO IS NOT PRESENTED IN THIS CASE BECAUSE THE FIFTH CIRCUIT EXPLICITLY LOOKED TO TEXAS LAW TO DECIDE THAT INTEREST FOLLOWS PRINCIPAL

Petitioners' invocation of federal common law here is wholly out of place. The only issue before this Court is the Fifth Circuit's treatment of federal constitutional law, or, more precisely, its treatment of the Takings Clause jurisprudence already defined by this Court in *Webb's*.⁶ Whether *Webb's* applies in the IOLTA context is squarely presented in Question One. As the applicability of federal common law was not raised below, Question Two is not presented in this case and adds nothing to the resolution of the constitutionality of Texas' IOLTA program.

This Court has made it quite clear that "[o]rdinarily, this Court does not decide questions not raised or resolved in the lower court." *Patrick v. Burget*, 486 U.S. 94, 99 n.5 (1988); *Adams v. Robertson*, 117 S. Ct. 1028 (1997). Contrary to the position taken by Petitioners, the Fifth Circuit explicitly relied on Texas law in deciding this case. The court began its discussion of the legal principles underlying this case as follows:

State law defines "property" and the United States Constitution protects private property from government encroachment. Texas observes the traditional rule that

⁶ Indeed, the Eleventh and First Circuits, in deciding that interest earned on client funds deposited into IOLTA accounts did not belong to clients, did not rely on the applicability of federal general common law; instead, they rejected the applicability of *Webb's*. See *Cone*, 819 F.2d at 1007; *Massachusetts Bar Foundation*, 993 F.2d at 975-76.

"interest follows principal," which recognizes that interest earned on a deposit of principal belongs to the owner of the principal.

Pet. App. 8a (citing *Sellers v. Harris County*, 483 S.W.2d at 243 (footnotes omitted)). The Fifth Circuit could not have understood more plainly or followed more dutifully its obligation to look to state law for the parameters of private property. The court's opinion does not even mention the phenomenon of "general federal common law," much less make an attempt to resolve what that law might be.

Moreover, after reviewing the panel's opinion and reasoning in this case, Petitioners did not present this federal common law issue for the Fifth Circuit to consider upon rehearing. Their failure to do so undermines any claim that they are forced by virtue of the Fifth Circuit's reasoning to present this issue to the Court; instead, Petitioners are merely searching for a way to cast the Fifth Circuit's decision in the worst possible light. However, this issue is a red herring whose only effect could be to obfuscate the real issues and confuse the Court.

Petitioners pose the general federal common law issue for two possible reasons. First, under the doctrine announced in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), there is no general federal common law; to the extent the Fifth Circuit relied on such a body of law, it must necessarily have decided this case improperly. Second, even if Petitioners are taken as referring to the creation of a narrow category of federal common law, any such action would be proper only upon meeting a heavy burden. As detailed by this Court in *Boyle v. United Technologies*, 487 U.S. 500 (1988), a party seeking to vindicate rights by establishing a body of federal common law must first show that the relevant area of law is one of "uniquely federal interest." In addition, the party must persuade the court that a "significant conflict" exists between an "identifiable federal policy or interest and the [operation] of state law," or the application of state law would "frustrate specific objectives" of federal legislation. *Id.* at

507 (quotations omitted). Petitioners may wish to cast the Fifth Circuit's opinion as failing to weigh this heavy burden.

However, the Fifth Circuit decided this case on neither general federal common law nor on the sort of federal common law contemplated in *Boyle*. *Webb's*, the basis for the Fifth Circuit's decision, is a constitutional law case, not a federal common law case. It settled that the Fifth Amendment requires states to abide by the parameters of their own definitions of property: "a State, by *ipse dixit*, may not transform private property into public property without compensation." 494 U.S. at 164. And while constitutional law may be common law in the sense that constitutional cases use *stare decisis* as a means of shaping general legal principles to fit detailed factual situations, there is a clear distinction between invoking the Constitution as a basis for decision and invoking federal common law in substantive areas, such as product liability, that do not refer directly to the Constitution for guiding principles. The Fifth Circuit, like *Webb's*, decided this case as a matter of constitutional law.

Accordingly, because the Fifth Circuit did not decide this case based on federal common law, this Court should deny the writ as to Question Two.

CONCLUSION

For the foregoing reasons, the Petition should be granted as to Question One and denied as to Question Two.

Respectfully submitted,

MICHAEL J. MAZZONE
9 Greenway Plaza
Suite 2300
Houston, TX 77046
(713) 940-6001
Pro Se

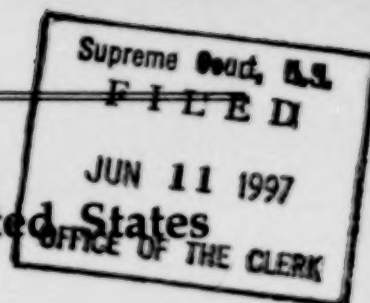
DANIEL J. POPEO
RICHARD A. SAMP
(Counsel of Record)
WASHINGTON LEGAL FOUNDATION
2009 Massachusetts Ave., NW
Washington, DC 20036
(202) 588-0302

DONALD B. AYER
THOMAS M. FISHER
JONES, DAY, REAVIS & POGUE
1450 G St., NW, Suite 700
Washington, DC 20005-2088
(202) 879-3939

*Attorneys for Respondents WLF
and William R. Summers*

May 5, 1997

In The
Supreme Court of the United States
October Term, 1996



HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALES,
HON. JACK HIGHTOWER, HON. NATHAN L. HECHT,
HON. LLOYD DOGGETT, HON. JOHN CORNYN,
HON. BOB GAMMAGE, HON. CRAIG T. ENOCH,
HON. ROSE SPECTOR, TEXAS EQUAL ACCESS TO
JUSTICE FOUNDATION, AND W. FRANK NEWTON, IN HIS
OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS
EQUAL ACCESS TO JUSTICE FOUNDATION,

Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

**Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

**PETITIONERS' REPLY TO RESPONDENTS'
MEMORANDUM IN RESPONSE TO THE PETITION**

NANCY TREASE
Office of the Attorney General
of Texas
P.O. Box 12548, Capitol
Station
Austin, Texas 78711
(512) 475-4075

Attorneys for Petitioners
Hon. Thomas R. Phillips,
Hon. Raul A. Gonzales, Hon.
Jack Hightower, Hon. Nathan
L. Hecht, Hon. Lloyd Doggett,
Hon. John Cornyn, Hon. Bob
Gammage, Hon. Craig T.
Enoch, and Hon. Rose Spector

DARRELL E. JORDAN
H. ROBERT POWELL*
BRITTAN L. BUCHANAN
DAVID J. SCHENCK
HUGHES & LUCE, L.L.P.
111 Congress, Suite 900
Austin, Texas 78701
(512) 482-6800

Attorneys for Petitioners
Texas Equal Access to Justice
Foundation, and W. Frank
Newton, In His Official
Capacity as Chairman
of the Texas Equal Access
to Justice Foundation

June 10, 1997

**Counsel of Record*

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**PETITIONERS' REPLY TO RESPONDENTS'
MEMORANDUM IN RESPONSE TO THE PETITION**

The Petitioners, the individual Justices of the Texas Supreme Court, the Texas Equal Access to Justice Foundation, and W. Frank Newton, in his official capacity as Chairman of the Texas Equal Access to Justice Foundation, respectfully file this Reply to Respondents' Memorandum in Response to the Petition to show the Court, further, the reasons a writ of certiorari should issue to address both of the Questions Presented in the Petition filed and docketed in this case on April 4, 1997.

I. RESPONDENTS HAVE AGREED THAT THIS COURT SHOULD GRANT THE WRIT TO RESOLVE A CIRCUIT CONFLICT ON A RECURRING QUESTION OF NATIONAL IMPORTANCE REGARDING WHETHER IOLTA INTEREST IS A COGNIZABLE PROPERTY INTEREST OF THE CLIENT OR LAWYER UNDER THE FIRST OR FIFTH AMENDMENTS TO THE U.S. CONSTITUTION

By their Memorandum in Response to the Petition, Respondents have agreed that the conflict between the Circuits over the ownership of IOLTA-derived interest poses a recurring question of national importance that is squarely presented in this case. Resp. Br. p. 6. Respondents also agreed that the conflict involves a legal question, and that no further proceedings below are required to develop facts instructive on the issue presented. Resp. Br. p. 11.¹

¹ There is no basis for Respondents' assertion that if the Fifth Circuit is reversed, "the lower courts would need to

The conflict between the Circuits focuses precisely on IOLTA's primary premise that clients have no reasonable expectation to earn interest on funds deposited in IOLTA accounts. As set forth in the various amicus briefs in support of the Petition, resolution of this conflict is of national importance because the premise of all IOLTA programs has been called into question. The First and Eleventh Circuit Courts, seven state supreme courts, and a California appellate court all held that the interest earned on funds deposited in IOLTA accounts is not clients' property.² The Fifth Circuit, however, held that

address whether the clients could in fact accumulate interest on short-term and nominal deposits absent the strictures of the IOLTA regulations." Petitioners have repeatedly acknowledged that if client funds deposited in an individual or pooled account can legally and ethically earn a net return to the client in *any* amount, the funds *are not* eligible for deposit into an IOLTA account. (R. Vol. I, p. 159; R. Vol. IV, p. 529; R. Vol. VI, p. 907.) Accordingly, if there is *any* legal and ethical way by which client funds may earn interest for the client, the funds are not eligible for placement in an IOLTA account. Thus, by definition of the IOLTA program, the inquiry suggested by Respondent is irrelevant.

² *Washington Legal Found. v. Mass. Bar Found.*, 993 F.2d 962 (1st Cir. 1993); *Cone v. State Bar of Fla.*, 819 F.2d 1002 (11th Cir.), cert. denied, 484 U.S. 917 (1987); *Petition by Mass. Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985); *In re Adoption of Amendments to C.P.R.D.R. 9-102 IOLTA*, 102 Wash.2d 1101 (Wash. 1984); *In re Interest on Lawyers' Trust Accounts*, 279 Ark. 84, 648 S.W.2d 480 (1983); *In re Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *In re N.H. Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258 (1982); *In re Minn. State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981); see also *Carroll v. State Bar of Cal.*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (Cal. Ct. App. 1984), cert. denied sub nom, *Chapman v. State Bar of Cal.*, 474 U.S. 848 (1985) (intermediate California appellate court upheld IOLTA Program against constitutional challenge).

IOLTA interest belongs to clients because they are the owners of the principal, regardless whether the clients had any reasonable expectation to receive interest on that principal after depositing the funds with their lawyers. 94 F.3d 996, 1002-1003 (1996); Pet. App. pp. 12-13. By abandoning the "reasonable expectation" component of this Court's takings analysis, the Fifth Circuit's decision creates a split among the Circuits that goes to the heart of this Court's takings jurisprudence. The Court should grant the writ to resolve this significant conflict.

II. THIS CASE PRESENTS THE EQUALLY IMPORTANT QUESTION WHETHER THE FIFTH CIRCUIT ADEQUATELY DEFERRED TO STATE LAW UNDER PRINCIPLES OF COMITY AND FEDERALISM

The single issue decided by the Fifth Circuit was whether a property right exists in IOLTA-derived interest antecedent to Respondents' constitutional claims. To maintain a cooperative judicial federalism, and avoid premature adjudication of constitutional questions, it is important to avoid federal court error in deciding state law questions antecedent to constitutional issues. *Arizonaans for Official English v. Arizona*, 65 U.S.L.W. 4169 (March 3, 1997). As discussed more fully on pages 19-22 of the Petition, in determining whether or not a property right exists, the Fifth Circuit should have based its decision on a meaningful analysis of state law to determine the rule that the Texas Supreme Court would probably

follow. The Fifth Circuit should not have indulged its own preferences as to what is a more enlightened, or less "shortsighted," legal rule; for there is no federal general common law of property on which to base a determination that such a property right exists.³ *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), see also *Oregon Ex. Rel. State Land Board v. Corvallis Sand & Gravel Co.*, 429 U.S. 363, 378-379 (1977) (property ownership is not governed by a general federal law, but by state law) (Rehnquist, J.).

The Fifth Circuit, however, did little more than pay token homage to state law, merely reciting the generic rule that "interest follows principal" found in *Sellers v. Harris Co.*, 483 S.W.2d 242 (Tex. 1972) (approximately \$6,000 in interest earned per month on \$1,000,000 in

³ The Fifth Circuit sought to create its own federal general common law of property when it paid too little deference to Texas law by failing to assess how the Texas Supreme Court would rule on the specific property question in issue. The second of the "Questions Presented" by the Petition thus lays before this Court the issue whether there exists a body of federal general common law upon which the Fifth Circuit could have validly rested its decision, rather than following principles of comity and federalism that require deference to determinations of the issue by the Texas Supreme Court. Contrary to Respondents' assertion, the Fifth Circuit's failure to pay adequate deference to Texas law was brought to the Fifth Circuit's attention on petition for rehearing, "[i]n light of the Texas Supreme Court's specific finding that certain client funds are eligible for deposit in an IOLTA account because interest income cannot reasonably be earned to benefit the clients, the Panel misapplied or paid too little deference to the Texas Supreme Court's pronouncement of Texas law." Petition for Panel Rehearing p. 8. By footnote to that same statement, Petitioners urged the Panel to "certify the question to the Supreme Court of Texas."

interpleaded funds). *Sellers* is quite clearly distinguishable upon a critical point, for in that case there was obviously a reasonable expectation of receiving interest beyond the costs of administration of the funds. The Fifth Circuit failed to consider whether the Texas Supreme Court would find the generic rule "interest follows principal" has exceptions under Texas law, particularly where there is no reasonable expectation of receiving interest. The Court also failed to explore the rationale upon which the Texas Supreme Court founded the Texas IOLTA Program and the property interest implications of that rationale, and failed to consider the specific finding by the Texas Supreme Court with respect to funds eligible for deposit in IOLTA accounts that "interest income cannot reasonably be earned to benefit individual clients for whom the funds are held." Pet. App. p. 56a. The Fifth Circuit simply held that IOLTA interest belongs to clients because interest follows principal. 94 F.3d at 1002; Pet. App. p. 12.

Respondents attempt to disguise this lack of deference to Texas law by arguing that the Fifth Circuit based its decision on constitutional law, as this Court did in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980). However, the sole issue decided by the Fifth Circuit was whether clients have a property right in interest earned on their funds deposited in IOLTA accounts. As this Court has repeatedly noted, whether a property right exists is not determined by constitutional law. *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 538 (1985); *Webb's*, 449 U.S. at 161; *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). Moreover, the issue in *Webb's* was not whether a property right in earned interest existed, but whether a

state statute could constitutionally direct that the interest accrue to the state. This Court held that a state cannot recharacterize private funds into public funds and avoid a takings claim. *Webb's*, 449 U.S. at 164. Thus, the application of constitutional law in *Webb's* was whether or not property was taken, not whether a property right existed under state law. Indeed, as noted in the Petition, *Webb's* is easily distinguishable on its facts, because there was a manifest reasonable expectation of the principal funds at issue in *Webb's* earning interest in excess of the costs of administration. Moreover, this Court made clear the narrow confines of its decision.⁴ Because the Fifth Circuit's decision below was not based on application of constitutional law, nor on a determination of how the Texas Supreme Court would rule on the existence of a property right in IOLTA interest, the question whether the Fifth Circuit paid adequate deference to state law is raised and should be addressed by this Court.

CONCLUSION

Both questions presented in the Petition warrant this Court's consideration. If left unresolved, the Circuit conflict threatens to undermine important programs across the nation that affect millions of people. The conflict also

⁴ "This case presents the issue whether it is constitutional for a county to take as its own, under the authority of a state statute, the interest accruing on an interpleader fund deposited in the registry of the county court. when a fee, prescribed by another statute, is also charged for the clerk's services in receiving the fund into the registry." *Webb's*, 449 U.S. at 155-156.

goes beyond the IOLTA context by calling into doubt this Court's long-held component of takings jurisprudence – that an expectation of property subject to constitutional protection must be reasonable. Moreover, the decision of the court of appeals below poses the important question of the deference to be afforded state law by a federal court, particularly when state law is determinative of an issue antecedent to constitutional claims.

For the foregoing reasons, and the reasons set forth in the Petition, a writ of certiorari should issue on both questions presented in the Petition, the decision of the court of appeals below should be reversed, and the decision of the district court affirmed in all respects.

Respectfully submitted,

NANCY TREASE
Office of the Attorney
General of Texas
P.O. Box 12548, Capitol
Station
Austin, Texas 78711
(512) 475-4075

Attorneys for Petitioners
Hon. Thomas R. Phillips,
Hon. Raul A. Gonzales,
Hon. Jack Hightower,
Hon. Nathan L. Hecht,
Hon. Lloyd Doggett,
Hon. John Cornyn,
Hon. Bob Gammage,
Hon. Craig T. Enoch,
and Hon. Rose Spector

June 10, 1997

DARRELL E. JORDAN
H. ROBERT POWELL*
BRITTAN L. BUCHANAN
DAVID J. SCHENCK
HUGHES & LUCE, L.L.P.
111 Congress, Suite 900
Austin, Texas 78701
(512) 482-6800
Attorneys for Petitioners
Texas Equal Access to
Justice Foundation, and
W. Frank Newton, In His
Official Capacity as
Chairman of the Texas
Equal Access to Justice
Foundation

*Counsel of Record

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1996

HON. THOMAS R. PHILLIPS, et al.,

Petitioners,

vs.

WASHINGTON LEGAL FOUNDATION, et al.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF OF *AMICI CURIAE* IN SUPPORT OF
THE PETITION FOR WRIT OF CERTIORARI

- * Peter M. Siegel, Esq.
Randall C. Berg, Jr., Esq.
JoNel Newman, Esq.
Florida Justice Institute, Inc.
2870 First Union Financial Center
200 South Biscayne Boulevard
Miami, Florida 33131-2310
305-358-2081

Attorneys for *Amici Curiae*

- * Counsel to be served,
Member of the Bar of the Court

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IN THE
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Respondents.

**BRIEF OF *AMICI CURIAE* IN SUPPORT OF
THE PETITION FOR WRIT OF CERTIORARI**

INTEREST OF *AMICI CURIAE*

The Texas Interest on Lawyers' Trust Accounts Program, like the 50 other similar programs throughout the country (herein collectively referred to as "Interest on Lawyers' Trust Account Programs," or "IOLTA" programs) operates on the premise that nominal sums of money, or short term deposits, held by attorneys on behalf of their clients, constitute an unused economic resource which may be mobilized to generate income to improve the delivery of legal services to the poor. In short, IOLTA establishes a unique method of financing civil legal aid by harnessing assets that, before adoption of the program, were neither used nor capable of use.

The eighty-four (84) *amici curiae*, who are set out in the Addendum to this Brief, and who file this Brief with the consent of the parties, are all organizations vitally interested in the continued growth and success of IOLTA programs as a mechanism for bringing the concept of equal justice under the law a step closer to reality. The forty (40) participating state bar associations have all been instrumental in creating IOLTA programs in their respective states. The forty (40) participating IOLTA administering agencies all collect IOLTA generated funds and distribute them to providers of legal services to the poor, and for other worthy law-related public purposes. The other *amici curiae* are all organizations vitally interested in furthering the principle of equal justice under law for all.

The Fifth Circuit's decision casts a dark cloud on the continued vitality of a program which has justifiably deserved the plaudits it has received from the bench, the bar, the media, and the public. As evident from the multiple challenges to IOLTA programs filed by Respondent, the Washington Legal Foundation, those who oppose legal services to the poor will continue to file suits, with the continuing risk of varying adjudications, until the issue is finally resolved by this Court.

Each participating *amici curiae* believes that IOLTA is critically important to ensuring that those in need of legal services do not go without. Their participation, as well as the separate *amicus curiae* brief of the American Bar Association, all attest to the nationwide acceptance of the IOLTA concept by a broadly representative sample of the legal profession. Firmly believing that IOLTA programs are in the best tradition of the legal profession and not violative of the Fifth Amendment, *amici curiae* fully support the Justices of the Texas Supreme Court and the Texas Equal Access to Justice Foundation.

REASONS FOR GRANTING THE WRIT

THE FIFTH CIRCUIT'S DECISION STRIKES DOWN A PROGRAM WHICH HAS BEEN ACCEPTED IN ALL 50 STATES — A PROGRAM WHICH THE RESPONDENTS ADMIT DOES NOT INJURE THEM, EVEN TO THE EXTENT OF A PENNY — CONTRARY TO THE DECISIONS OF TWO OTHER CIRCUITS AND SEVEN STATE SUPREME COURTS

A. The IOLTA Premise

IOLTA establishes a unique method of financing civil legal aid to the poor by harnessing assets that, before adoption of the program, were neither used nor capable of being used to produce income. With IOLTA, all the nominal or short term funds held by an attorney, funds which by themselves are incapable of producing income net of expenses, are pooled in a single NOW account, and the resulting net income is used to fund public service activities, with the overwhelming majority of the funding used for legal aid activities.

In rejecting Texas' IOLTA program, the Fifth Circuit, unlike the First and Eleventh Circuits, and the 45 state supreme courts which have approved similar programs, refused to recognize that IOLTA combines lawyer trust account mandates, banking law restrictions, and economic realities, to produce net income where, previously, there was no net income.

IOLTA programs originated in Australia, initially as a way to finance client security funds, and then spread to Canada, where some of the IOLTA generated funds were used for legal aid. England & Carlisle, *History of Interest on Trust Accounts Program*, 56 Fla. B.J. 101 (1982). In the

United States, Florida was the first state to authorize an IOLTA program, *In re Interest on Trust Accounts*, 356 So.2d 799 (Fla. 1978), with implementation commencing in 1981. *Matter of Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981).

IOLTA is simplicity itself. Attorneys routinely receive funds in trust for future transactions. If the funds are large in amount or expected to be held for a long time, the attorneys customarily deposit the funds in an interest-bearing account for the benefit of the client. IOLTA does not change this time-honored practice.

Often, however, lawyers hold clients' money in amounts which are very small or expected to be held for a very short period of time, making it impracticable and uneconomical to invest the money productively for the client. Bank services charges, as well as bank rules limiting the payment of interest on accounts not open as of the end of a month, or for a specific time period, all preclude the possibility of earning interest on many client trust account deposits. Likewise, the wide range of costs that lawyers incur, including (1) the time to determine whether investment is warranted, (2) the time to obtain tax identification information, (3) the time to open a separate, income producing account, (4) law firm bookkeeping on a periodic basis, (5) preparation of tax reporting forms, and (6) the time required to close a separate, income producing account, preclude the earning of net income on many client trust accounts. See A.B.A. Task Force and Advisory Board on Interest on Lawyer Trust Accounts, *Report to the Board of Governors*, 22-24 (July 1982). Now, as a result of the creation of the IOLTA programs, all the inherently unproductive client deposits are pooled in interest-bearing NOW accounts. The interest earned only because of the IOLTA pooling is used to support law-related public services. As Respondents Mazzone

and Summers acknowledged before the district court, clients lose nothing because of IOLTA.

A few brief examples of the nonproductive funds one would expect to find in an attorney's trust account will demonstrate why no client is injured, not even to the extent of a penny.

1. Cost Deposits. A client involved in litigation is often required to provide costs in advance. In entrusting funds to the lawyer for the payment of costs, the client has no expectation of having the funds returned (although excess advances will be returned) nor any expectation of earning interest. The facts in *Cone v. State Bar*, 819 F.2d 1002 (11th Cir.), *cert. denied*, 487 U.S. 917 (1987), are typical. The client gave her attorneys a \$100 cost deposit. At the time of receipt, the small size of the deposit, as well as the expectation that the funds would be promptly disbursed, did not justify an effort to invest the funds. After disbursement, the small amount left over, \$13.75, also did not justify investment. Indeed, as a practical matter, \$13.75 is inherently incapable of being put to productive use for an individual. The approximately 4¢ per month in earnings on \$13.75, at current NOW account rates, would not offset bank service charges, let alone the costs incurred by attorneys to administer a separate interest-bearing account.

2. Real Estate Escrows. An attorney, representing the seller of a small piece of property, receives \$500 to be held in escrow. At closing, some thirty to sixty days later, the deposit is applied to the sales price. If closing does not take place, depending on the sales contract and other factors, either the buyer or seller may be entitled to the deposit. The interest on the deposit, \$2.19 per month, at current NOW account rates, would not justify the time and expense required to set up a separate NOW account.

3. Personal Injury Settlements. Settlements come from insurance companies in the form of checks or drafts. Banks customarily indicate a time period in which it is safe to assume that the insurance company has accepted the draft or the check has cleared, but in fact the credit to the lawyer's trust account may occur sooner. In addition, there are a number of circumstances under which monies from the check or draft may stay in the account for several days after disbursements are made. For example, assume \$50,000 is received by an attorney on a Monday. The lawyer's trust account check is mailed to the client that day. It is received and deposited by the client on Wednesday. It clears the lawyer's bank on Friday. Does the client have any expectation of receiving interest earned by the settlement amount during the "float" period? Clearly not. Moreover, the cost of opening a separate account to process the settlement proceeds would far exceed the \$28.76 that might be earned if the funds were placed in a separate, interest earning NOW account. Yet, as a result of IOLTA, that amount is available to support legal services to the poor.

4. Real Estate Closings. In many instances, real estate closings are done in law offices. The attorney may receive the funds by wire a day in advance, thereby producing a one day accrual of interest. Or, the closing may be unexpectedly delayed for a day or two to clear last minute problems. As with personal injury settlements, disbursement checks will not clear instantly. The short term float will produce interest that cannot readily be apportioned in any economic way. Before IOLTA, only banks benefited from the float. Now, the public shares in the benefit.

B. IOLTA's Nationwide Acceptance

This case cries out for the granting of certiorari because the impact of the Fifth Circuit's decision will be felt in every state in the nation. Today, all fifty states and the District of

Columbia have adopted IOLTA programs. Collectively, the programs have raised millions of dollars, primarily to support the provision of legal aid to the poor. With the cuts in federally funded legal services programs, IOLTA has become even more vital; it has become the second largest source of funds for legal aid programs.

Two basic reasons account for the overwhelming acceptance of IOLTA. First, the legal profession fully recognizes the critical need for additional resources to improve the justice system. Second, while the public, and particularly the poor benefit, clients suffer no loss when their nominal or short terms deposits, only because they are pooled in an IOLTA account, produce income net of expenses.

The highest courts of seven states, in adopting IOLTA programs for their respective states, have expressly held that IOLTA does not violate the Fifth Amendment. *Matter of Interest on Trust Accounts*, supra, 402 So.2d 389; *Petition of Minnesota State Bar Association*, 332 N.W.2d 151 (Minn. 1982); *Petition of New Hampshire Bar Association*, 122 N.H. 971, 453 A.2d 1258 (1982); *Matter of Interest on Lawyers' Trust Acc.*, 672 P.2d 406 (Utah 1983); *In the Matter of the Adoption of Amendments to CPR DR 9-102 IOLTA*, 102 Wash.2d 1101 (1984); *In the Matter of Interest on Lawyers' Trust Accounts*, 283 Ark. 252, 675 S.W.2d 355 (1984), rev'g, 279 Ark. 84, 648 S.W.2d 480 (1983); *Petition by Massachusetts Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985).

In addition, like Texas, thirty-seven other state supreme courts and the District of Columbia Court of Appeals have adopted IOLTA programs without formal opinion, although in each jurisdiction the Fifth Amendment was raised as a bar

to adoption of the program.¹ IOLTA programs have been established by legislation in five states, California, Connecticut, Maryland, New York and Ohio. The American Bar Association has endorsed the ethical propriety of IOLTA programs. A.B.A. Formal Opinion 348, 68 ABA J. 1502 (1982).

Prior to the ruling of the Fifth Circuit, no court in an adversary proceeding had ever rejected an IOLTA program. In an identical challenge brought by the Washington Legal Foundation, Massachusetts' IOLTA program was upheld. *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962 (1st Cir. 1993). The Florida program was upheld in *Cone v. State Bar*, *supra*, 819 F.2d 1002. The California IOLTA program was upheld in *Carroll v. State Bar of California*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (4th Dist. 1984), *cert. denied sub nom. Chapman v. State Bar of California*, 474 U.S. 848 (1985). In *Ronwin v. Supreme Court of Iowa*, (No. 84-1641), *cert. denied*, 471 U.S. 1101 (1985), this Court refused to review the Iowa Supreme Court's rulemaking adoption of an IOLTA program.

The decision of the Fifth Circuit stands in sharp contrast to the literally hundreds of judges from 45 states, the District of Columbia, and the First and Eleventh Circuits,

1. The Supreme Courts of Arkansas, Maine, Michigan and North Carolina initially rejected and then approved IOLTA programs. The Supreme Court of Indiana initially refused to adopt an IOLTA program on the grounds that it violates the State's Rules of Professional Conduct. *Matter of Indiana State Bar*, 550 N.E.2d 311 (Ind. 1990). Legislation adopting an IOLTA program was struck down on separation of powers grounds. *Matter of Public Law No. 154-1990*, 561 N.E.2d 791 (Ind. 1990). Thereafter, the Indiana Supreme Court, acting pursuant to its rulemaking power, adopted an IOLTA program.

who have concluded that the Fifth Amendment is not a bar to implementation of an IOLTA program.

C. The Fifth Circuit's Decision is Fundamentally Flawed

The Fifth Circuit's decision directly conflicts with controlling decisions of this Court setting forth the analytical framework necessary to evaluate a Fifth Amendment claim that property has been taken without just compensation. The fundamental flaw is the Fifth Circuit's failure to recognize that nominal or short term trust account deposits do not produce, and are inherently incapable of producing, any property which would ever benefit the client.

Before IOLTA only banks benefited from the use of inherently unproductive client trust funds. Now, the justice system, the public, and the poor benefit. If IOLTA is abolished, financial institutions will receive a windfall, some of the poor will again be denied access to the justice system, and clients with nominal or short-term deposits will find their position unchanged. Indeed, attorney-Respondent Mazzone admits that the client funds he places in his IOLTA account "cannot practicably be placed into separate interest-bearing accounts, because the additional costs of establishing and maintaining such accounts usually would exceed any interest I could earn for my clients." And client-Respondent Summers admits that his funds were placed in an IOLTA account because his attorney told him that "the cost of establishing and administering a separate account ... most likely would exceed any interest that could be earned on those funds."

In deciding that IOLTA offends the Fifth Amendment, the Fifth Circuit did not meaningfully address the issue of whether the Respondents have any property interest in the income created only because of the IOLTA program. The decision failed to apply the holding of *Board of Regents of*

State Colleges v. Roth, 408 U.S. 564 (1972), that in order to recognize a property interest, the claimant must be able to identify a legitimate claim of entitlement. Yet, implicit in the rulemaking of the Texas Supreme Court when it adopted the Texas IOLTA program, is the holding that interest earned on pooled nominal or short-term funds, which by themselves are incapable of producing income net of expenses, and which are held in an attorney's trust account, do not belong to the owner of the principal.

Having assumed the existence of property, despite the lack of Texas law establishing any entitlement in the circumstances herein presented, the Fifth Circuit overlooks, indeed it never cites, the multifactor balancing test of *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978), which examines taking claims by looking to the character of the governmental action and the economic impact of that action on the claimant, and particularly, the extent to which the action has interfered with distinct investment-backed expectations. Yet, *Penn Central* leads to the inevitable conclusion that IOLTA programs do not take the client's property. Or as Justice Peckham put it nearly a century ago, if a claimant is "not injured to the extent of a penny . . . his abstract rights are unimportant." *Hooker v. Burr*, 194 U.S. 415, 419 (1904).

Because established takings doctrine requires at least some loss, and because Respondents admit that they suffered no loss due to the operation of the Texas IOLTA program, their Fifth Amendment claim is not well-founded. If customary trust rules are applied, a client has no claim to interest earned in situations where the interest earned does not exceed the administrative costs incurred. IOLTA operates on that very real set of facts. Absent at least some real loss, no caselaw from this or any other court, turns a regulatory scheme into a taking.

Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155 (1980) is not to the contrary. The fund at issue in *Webb's*, more than \$1.8 million, clearly could, and did, produce net income after expenses. *Webb's* certainly does not preclude the IOLTA proponent's calculus that recognizes the real cost of producing net income. Before IOLTA only banks benefited from the use of inherently unproductive client trust funds. Now, the justice system and the public benefits. If the Fifth Circuit's decision stands, only banks, not the public and certainly not clients, will benefit.

CONCLUSION

This case is of vital importance to Texas, Louisiana and Mississippi. It is also of vital importance to the other 47 states outside the Fifth Circuit and to the District of Columbia. Each of these jurisdictions has adopted an IOLTA program as a means of helping to provide equal justice to all. Because of the national importance of IOLTA, conflict in the circuits, and conflict with the states, *amici curiae* urge that certiorari be granted and that the decision of the Fifth Circuit be reversed.

Respectfully submitted,

* Peter M. Siegel, Esq.
Randall C. Berg, Jr., Esq.
JoNel Newman, Esq.
Florida Justice Institute, Inc.
2870 First Union Financial Center
200 South Biscayne Boulevard
Miami, Florida 33131-2310
305-358-2081

Counsel for *Amici Curiae*
* Counsel to be served,
Member of the Bar of the Court

ADDENDUM

THE AMICI CURIAE

Alabama Law Foundation, Inc.
Alabama State Bar
Arizona Bar Foundation
State Bar of Arizona
Arkansas Bar Association
Arkansas IOLTA Foundation, Inc.
The Legal Services Trust Fund Commission of the
State Bar of California
The State Bar of California
Colorado Bar Association
Colorado Lawyers Trust Account Foundation
Connecticut Bar Association
The Connecticut Bar Foundation
The Florida Bar
The Florida Bar Foundation
Georgia Bar Foundation
Hawaii Justice Foundation
Hawaii State Bar Association
Idaho Law Foundation, Inc.
Idaho State Bar
Lawyers Trust Fund of Illinois
Illinois State Bar Association
Indiana State Bar Association
Lawyer Trust Account Commission of the Supreme
Court of Iowa
The Iowa State Bar Association
Kansas Bar Foundation
Kentucky IOLTA Fund
Louisiana Bar Foundation
Louisiana State Bar Association
Maine Bar Foundation
Maine State Bar Association

Maryland Legal Services Corporation
Maryland State Bar Association
State Bar of Michigan
Michigan State Bar Foundation
Minnesota State Bar Association
The Mississippi Bar Foundation
The Missouri Bar
Missouri Lawyer Trust Account Foundation
Montana Law Foundation
State Bar of Montana
National Association of IOLTA Programs, Inc.
National Legal Aid and Defender Association
Nebraska Lawyers Trust Account Foundation
Nebraska State Bar Association
Nevada Law Foundation
State Bar of Nevada
New Hampshire Bar Association
New Hampshire Bar Foundation
The IOLTA Fund of the Bar of New Jersey
New Jersey State Bar Association
New Jersey State Bar Foundation
State Bar of New Mexico
New Mexico Bar Foundation
IOLTA Fund of the State of New York
New York State Bar Association
North Carolina Bar Association
North Carolina Association of Black Lawyers
North Carolina State Bar Plan for IOLTA
Ohio Legal Assistance Foundation
Ohio State Bar Association
Oklahoma Bar Association
Oklahoma Bar Foundation, Inc.
Oregon Law Foundation
Oregon State Bar
Pennsylvania Bar Association
Lawyer Trust Account Board (Pennsylvania)
Philadelphia Bar Association

Rhode Island Bar Association
Rhode Island Bar Foundation
South Carolina Bar
South Carolina Bar Foundation
State Bar of South Dakota
Tennessee Bar Foundation
Tennessee Bar Association
Vermont Bar Association
Vermont Bar Foundation
The Virginia Bar Association
Legal Services Corporation of Virginia
Legal Foundation of Washington
Washington State Bar Association
King County Bar Association (Washington)
West Virginia Bar Foundation
West Virginia State Bar
Wisconsin Trust Account Foundation, Inc.

24
No. 96-1578

Supreme Court, U. S.

FILED

MAY 5 1997

CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ,
HON. JACK HIGHTOWER, HON. NATHAN L. HECHT,
HON. LLOYD DOGGETT, HON. JOHN CORNYN,
HON. BOB GAMMAGE, HON. CRAIG T. ENOCH,
HON. ROSE SPECTOR, TEXAS EQUAL ACCESS TO JUSTICE
FOUNDATION AND ITS CHAIRMAN W. FRANK NEWTON,
Petitioners,

v.

WASHINGTON LEGAL FOUNDATION,
WILLIAM R. SUMMERS, AND MICHAEL J. MAZZONE,
Respondents.

**On Petition for a Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit**

**BRIEF FOR THE COLUMBUS BAR ASSOCIATION
AND THE LEGAL AID SOCIETY OF COLUMBUS
AS AMICI CURIAE IN SUPPORT OF PETITIONER**

RICHARD A. FRYE
CHESTER, WILLCOX & SAXBE
17 South High Street
Suite 900
Columbus, Ohio 43215
(614) 221-4000

RICHARD A. CORDRAY
Counsel of Record
4900 Grove City Road
Grove City, Ohio 43123
(614) 539-1661

Attorneys for the Amici Curiae

2317P

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ,
HON. JACK HIGHTOWER, HON. NATHAN L. HECHT,
HON. LLOYD DOGGETT, HON. JOHN CORNYN,
HON. BOB GAMMAGE, HON. CRAIG T. ENOCH,
HON. ROSE SPECTOR, TEXAS EQUAL ACCESS TO JUSTICE
FOUNDATION AND ITS CHAIRMAN W. FRANK NEWTON,
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v.

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AND THE LEGAL AID SOCIETY OF COLUMBUS
AS AMICI CURIAE IN SUPPORT OF PETITIONER**

INTEREST OF THE AMICI CURIAE

The Columbus Bar Association is a non-profit organization that was created to deal with issues involving the governance and responsibilities of the practicing bar. Among these responsibilities, in its view, is the need to address the persistent problem of assuring access to legal services for the economically

disadvantaged. In this regard, the Columbus Bar Association has been directly involved with the "Interest on Lawyers' Trust Account Program" ("IOLTA" program) in central Ohio, which has emerged as an innovative means of creating funding for legal services to the poor out of sources that could not be utilized to generate any income prior to the institution of this program.

The Legal Aid Society of Columbus is a non-profit organization that is committed to providing legal aid services to those who ordinarily do not have access to such services in our society, usually because of personal financial constraints. In recent years, as the Federal government's financial support for these services has declined and become more uncertain, the Legal Aid Society, like other similar groups around the country, has been able to draw upon the resources provided by IOLTA programs and other sources to continue their work. If IOLTA programs are disabled by decisions like the ruling of the court below, then the continued activities of non-profit organizations like the Legal Aid Society of Columbus will be jeopardized. The consequent harm to those who lack the resources to have meaningful access to our courts is obvious, and would cause them to suffer even greater difficulty in realizing the constitutional promise that they should have the "equal protection of the laws."

For these reasons, the amici curiae have a direct interest in the constitutional issues raised in this case, the resolution of which will dictate whether IOLTA programs will be able to continue to operate in every jurisdiction where they have been approved and implemented.¹

¹ Counsel for both petitioners and respondents have consented to the filing of this brief. Letters evidencing such consent are on file in the Clerk's office.

QUESTION PRESENTED

Whether state IOLTA programs, which aggregate client trust funds that would not otherwise earn any interest so that the interest on the combined funds can be utilized by non-profit organizations whose primary purpose is the direct provision of legal services to the poor, constitute an unconstitutional "taking" of property for public use without "just compensation."

REASONS FOR GRANTING THE WRIT

As petitioners have noted, IOLTA programs have been adopted and implemented in essentially the same form in 49 States, and Indiana, currently the lone exception, is now in the process of instituting such a program.² It is thus obvious that the issues raised in this case about the validity of these programs are of broad importance to the funding of legal services to the poor throughout this country. Rather than belabor this point, the amici will focus on the specific grounds of the disagreement among the lower courts on the takings issues raised in this case, in order to show the intractable nature of the split in those decisions. The amici also will discuss the doctrinal importance of these constitutional issues, which have not been, but should be, decided by this Court.

I. THE LOWER COURTS DISAGREE ABOUT WHETHER STATE IOLTA PROGRAMS TAKE PROPERTY WITHOUT JUST COMPENSATION IN VIOLATION OF THE TAKINGS CLAUSE.

Petitioners have noted that the ruling below conflicts with decisions rendered by two other federal courts of appeal and

² Although the Indiana Supreme Court had previously denied a petition to establish an IOLTA program, *see Matter of Ind. State Bar*, 550 N.E.2d 311 (Ind. 1990), it recently approved such a program in principle. *See* Pet. 3.

seven state supreme courts. See Pet. 12-16. This split among the courts was explicitly recognized by the court below and is ripe for review here because it is grounded on flatly irreconcilable views about the merits of the takings issues raised in the petition.

The first court to address the validity of state IOLTA program under the Takings Clause was the Florida Supreme Court. See *Matter of Interest on Trust Accounts*, 402 So. 2d 389 (Fla. 1981). In the course of its opinion rejecting the claim that its program constituted an improper taking, the court considered the applicability of the decision that this Court had issued the previous year in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980). In the *Webb's* case, a client was obliged by law to tender the \$1,800,000 purchase price of a business to the clerk of the court in an interpleader action and those funds earned more than \$100,000 in interest before the matter was finally resolved. The clerk was entitled by law to charge a separate fee for the services rendered in depositing and maintaining the funds. In these circumstances, this Court held that the Takings Clause was violated when the clerk ultimately closed the fund and returned the \$1,800,000, but refused to pay out the accrued interest to the client. *Id.* at 160-65.

The Florida Supreme Court noted that the administration of an IOLTA program differs from the circumstances of the *Webb's* case in material respects. Most important is the fact that all of the amounts deposited under the terms of an IOLTA program are funds that would be unable to earn interest on their own account, either because the amounts are too insignificant or the duration is too transitory to permit the accrual of interest that would make it feasible, in light of banking restrictions and administrative charges, to earn any actual return. See 402 So. 2d at 395. Based on this central distinction, the court concluded that the IOLTA program does not effect a "taking" within the meaning of the Fifth and Fourteenth Amendments:

The most relevant distinction [between an IOLTA program and the *Webb's* case], plainly, is the fact that no client is compelled to part with "property" by reason of a state directive, since the program creates income where there had been none before, and the income thus created would never benefit the client under any set of circumstances. . . . It follows that no client has a "property interest," in the constitutional sense, which is being taken from him by this program.

Id. at 395-96. On this basis, the Florida Supreme Court approved this method of "enhanc[ing] the capability of the legal profession to deliver legal services to the poor," which "has long been a cherished commitment of this Court." *Id.* at 396.

Over the ensuing years, a number of other state supreme courts confronted the same takings issue in determining whether to adopt essentially the same kind of program within their jurisdictions. These courts uniformly found that because -- aside from the provisions made under the IOLTA program itself -- "the earnings of funds held in trust accounts can benefit neither the attorney nor the client, but simply redound to the benefit of the depository institution," there is no taking of property in aggregating those funds for the purpose of generating a new source of income to fund legal services to the poor. *Matter of Interest on Lawyers' Trust*, 675 S.W.2d 355, 357 (Ark. 1984); see also *Petition of Minn. State Bar Ass'n*, 332 N.W.2d 151, 158 (Minn. 1982) ("There simply is no "property" now in existence that would be taken."). Many of these courts treated this issue by expressly applying the same rationale adopted by the Florida Supreme Court. See, e.g., *Petition by Mass. Bar Ass'n*, 478 N.E.2d 715, 718 (Mass. 1985) ("We agree with the Florida court's analysis and conclude that there is no constitutional impediment to the IOLTA proposal"); *Petition of N.H. Bar Ass'n*, 453 A.2d 1258, 1261 (1982) (same).

In the meantime, the objectors to the Florida IOLTA program brought their constitutional objections to the federal courts. In *Cone v. State Bar of Fla.*, 819 F.2d 1002 (11th Cir.), *cert. denied*, 484 U.S. 917 (1987), the Eleventh Circuit affirmed the trial court's ruling that upheld the validity of the program and rejected the claim that it effected an unconstitutional taking. It began by recognizing that the claim turned on the question "whether the interest earned on nominal or short term funds held in an IOLTA account was the property of the client for the purposes of the Fifth and Fourteenth Amendments." *Id.* at 1004. Although plaintiffs had argued that "interest follows principal," in accordance with traditional property law, the court stated that "when Justice Johnson observed in *Himely v. Rose*, 9 U.S. (5 Cranch) 313, 319 (1809), that 'interest goes with the principal, as the fruit with the tree,' his illustration necessarily assumed the existence of a fruit-bearing tree." 819 F.2d at 1004 (other quotes omitted). Because the IOLTA funds would not have been able to generate any income net of expenses apart from the organization and operation of the IOLTA program itself, the court held that the plaintiff had no "specific and legitimate 'claim of entitlement'" to funds created by the IOLTA program. *Id.* at 1004-05 (citing *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972), and *Perry v. Sinderman*, 408 U.S. 593, 601-02 (1972)). No "positive rules of substantive law or mutually explicit understandings" were identified to support the plaintiff's *post hoc*, unilateral claim that it should receive interest generated by the IOLTA program. *Id.*

The Eleventh Circuit took basically the same approach as the numerous state supreme courts in distinguishing this Court's decision in the *Webb*'s case. The funds in *Webb*'s, which "were sufficient in amount, and held for a sufficient period of time, to generate \$90,000 in interest over a year and a half" did "give rise to a legitimate claim of entitlement" to those proceeds. 819 F.2d at 1007. By contrast, the deposits made under the terms of the IOLTA program had no net value, for they could not

generate any "legitimate expectation of interest exclusive of administrative costs and expenses." *Id.* (internal quotes omitted). The court stressed that the point was *not* that the amount of income generated was slight and therefore subject to some sort of "de minimis" exception to the Takings Clause. Instead, the point was that because each individual deposit in the IOLTA program, standing alone, "could not earn *anything*," the program effected "*no taking* of any property" belonging to any individual depositor. *Id.* (emphasis added).

In 1990, the Indiana Supreme Court confronted the same constitutional issue and disagreed with the consistent direction taken by these other courts. *Matter of Ind. State Bar*, 550 N.E.2d 311 (Ind. 1990). Relying on the same quotation from Justice Johnson's 1809 opinion in *Himely* that was discussed and distinguished by the Eleventh Circuit in *Cone*, the court held that denying interest on the sum invested "amounted to a double wrong by depriving the person owed of the increase to which he was justly entitled and by allowing the one holding the funds to profit from the use of the funds that did not rightly belong to him." *Id.* at 312 (quotation omitted). The court went on to find the *Webb*'s decision controlling and declined to approve the proposed IOLTA program. In so holding, the court resolved the constitutional issue without addressing the contrary analysis of these points made in the previous decisions -- namely, that no client was "justly entitled" to funds generated by IOLTA programs on accounts that were not capable of earning any net income on their own, and that the only "profit" previously derived from those accounts had redounded to the sole benefit of the depository institutions. *Id.*

In 1993, similar constitutional claims reached the First Circuit in a challenge to the Massachusetts IOLTA program that was principally initiated by the same plaintiff that brought this case. See *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962 (1st Cir. 1993). There the plaintiffs

contended that "the IOLTA program's appropriation of interest from lawyers' trust accounts takes the beneficial use of client funds which constitutes an unconstitutional taking in violation of the Fifth and Fourteenth Amendments." *Id.* at 973. As in all of these cases, the court began by considering whether the plaintiffs had shown "that they possess a recognized property interest which may be protected by the Fifth Amendment." *Id.* The court recognized that the Constitution protects both tangible and intangible property rights, but quoted the *Webb*'s decision as holding that "a mere unilateral expectation or an abstract need is not a property interest entitled to protection." *Id.* at 973-74 (quoting *Webb*'s, 449 U.S. at 161).

In determining whether claims raised by individual clients to the proceeds generated by IOLTA funds amounted to protected "property" under these classifications, the court first ruled that the IOLTA program did not work "a physical invasion of real property" that would constitute a *per se* taking under this Court's precedents. *Id.* at 975. The First Circuit also agreed with the Eleventh Circuit's analysis in distinguishing the *Webb*'s case because "the plaintiffs do not have a property right to the interest earned on their funds held in IOLTA accounts." *Id.* at 975-76 (citing *Cone*, 819 F.2d at 1006-07). Based on this reasoning, the court dispatched the plaintiffs' taking claims by holding that "the IOLTA program does not occupy or invade the plaintiffs' property even temporarily" because "the interest earned on IOLTA accounts is not the plaintiffs' property." *Id.* at 976. The court went on to conclude that any regulation of private property that could be said to be accomplished through IOLTA programs was not significant because the plaintiffs did not have any legitimate "investment-backed" expectations to the use of the funds deposited under the IOLTA program. *Id.* (citing *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225 (1986)).

The First Circuit thus adopted the main features of the Eleventh Circuit's analysis of the takings issue. The core of that analysis, again, is that because individual client funds would not be able to earn interest on their own account net of expenses and administrative charges, the income generated by the operation of IOLTA programs is not "property" within the meaning of the Takings Clause. In addition, the First Circuit went further to analyze the takings issue from the standpoint of mere economic regulations, and found by the same rationale that individual clients had no legitimate "expectation-backed" expectations to control the use of any such proceeds that would not have accrued from their individual fund accounts. *See* 993 F.2d at 973-76.

The ruling below, however, is directly at odds with the analysis adopted by the First and Eleventh Circuits, as well as the overwhelming majority of state supreme courts. In the trial court, the parties did not dispute the facts that are material to the takings issue. In particular, the District Court found that the only funds eligible for the Texas IOLTA program, as with all of the IOLTA programs, are those which "could not reasonably be expected to earn interest for the client" over and above "the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred." *Washington Legal Found. v. Texas Equal Access to Justice Found.*, 873 F. Supp. 1, 4 (W.D. Tex. 1995) (quoting Texas State Bar IOLTA Rule 6).³ Based on these facts, the plaintiffs raised the same takings claims that had been raised in turn in the *Cone* and *Massachusetts Bar* cases, alleging that the

³ The District Court took special pains to note that there was no genuine issue of material fact concerning whether "sub-accounting is a practical means of generating net interest for clients who deposit small amounts of money with their attorney" because it was conceded that "any type of account that can earn interest beyond the costs of maintaining such account is beyond the scope of IOLTA's coverage." 873 F. Supp. at 4 n.2.

IOLTA program effected a taking both of the interest generated by the IOLTA funds and of the "beneficial use" of their property through the operation of the program. *Id.* at 5.

The District Court squarely relied on the Eleventh Circuit and First Circuit decisions to reject plaintiffs' takings claims, finding "[t]he logic supporting both of these opinions" to be "compelling." *Id.* at 7; *see also id.* at 6-7 (discussing *Cone* and *Massachusetts Bar*). Applying their analysis, the District Court held that the IOLTA program did not "interfere with interests that are sufficiently bound up with the reasonable expectations of the person asserting the deprivation" to be recognized as a constitutional taking. It therefore distinguished the *Webb*'s decision in precisely the same manner as those courts had:

In sum, the property rights of the Plaintiffs in this action and the claimants in *Webb*'s are clearly different, and, as there is no property interest or expectation appropriated, there is no taking for Fifth Amendment purposes. Accordingly, the Court finds that the Plaintiffs have failed to allege a cognizable Fifth Amendment takings claim with regard to the interest generated by funds placed in IOLTA accounts.

Id. at 7.

On appeal, the Fifth Circuit reversed, explicitly rejecting the core analysis that had been adopted by the Eleventh and First Circuits and by many state supreme courts. *See Washington Legal Found. v. Texas Equal Access to Justice Found.*, 94 F.3d 996, 1000-04 (5th Cir. 1996). Instead, the court resurrected the "interest follows principal" approach that had been followed by the Indiana Supreme Court, but was directly repudiated by the Eleventh Circuit in *Cone*. "In light of this rule, it seems obvious that the interest earned in the IOLTA accounts is the property of the clients whose money is held in those accounts." *Id.* at

1000. The Fifth Circuit acknowledged that the District Court's contrary ruling "adopted the theory espoused by the First and Eleventh Circuits, which circumvents this rule," but contended that this reasoning "does not give proper weight to Supreme Court precedent." *Id.*

The Supreme Court precedent that the Fifth Circuit found most compelling, of course, was the *Webb*'s decision, which the court characterized as presenting "a similar situation" to the state IOLTA programs. *Id.* Reading that decision broadly, the court concluded that it represented a general holding that under any circumstances, the interest generated on any principal must be allocated to the ultimate owners of the principal. *Id.* at 1000-02. The court then considered and rejected the understanding of *Webb*'s that forms the central premise of the "numerous" state court rulings to the contrary, as well as the Eleventh Circuit's decision in *Cone*. Treating the distinction between the *Webb*'s case and IOLTA programs as merely a difference of degree, rather than as a difference of kind, the court opined that "inherent in [the Eleventh Circuit's] *Cone* analysis is the notion that the value of the alleged property involved determines whether there is a cognizable property interest."⁴

The Fifth Circuit went on to criticize the Eleventh Circuit's decision in *Cone* for "fail[ing] to consider the precise events of the transaction," contending that "a bank pays interest on the account and then deducts fees." *Id.* at 1003. Ignoring the crucial fact that these "fees" and administrative charges had been found by the trial court to exceed any interest payments that would be generated by any individual client's IOLTA funds, the court concluded that "a property interest attaches the moment that the interest accrues" and remains vested in the

⁴ The court thus acknowledged but disbelieved the Eleventh Circuit's express admonition that the *Cone* decision should not be taken to establish "a de minimis standard for Fifth Amendment takings." *Id.* at 1002 & n.36 (quoting *Cone*, 819 F.2d at 1007).

owner of the principal. *Id.* In a footnote, the court also dismissed the First Circuit's contrary decision as resting on "dicta," despite the fact that the plaintiffs had raised the same takings claims in this case and the First Circuit's analysis of those claims had inevitably obliged it to determine whether a client has a cognizable "property" right in IOLTA funds, declaring that this essential issue "was not properly before" the First Circuit in deciding that case. *Compare id.* at 1002 n.35 with *Massachusetts Bar*, 993 F.2d at 973-76.

The ruling below thus stands with the 1990 decision by the Indiana Supreme Court in direct conflict with the decisions of several other state supreme courts. It expressly renounces the takings analysis employed by the Eleventh Circuit in an identical case, and weakly distinguishes the First Circuit's decision that had adopted the Eleventh Circuit's analysis when it addressed the same takings issues that are raised in this case. All of these other decisions by lower courts of last resort distinguish the *Webb*'s case, which the court below found to be controlling, on the ground that the client funds deposited in that case "were sufficient in amount, and held for a sufficient period of time," to "give rise to a legitimate claim of entitlement" to the proceeds. *Cone*, 819 F.2d at 1007; *see also Matter of Interest on Trust Accounts*, 402 So. 2d at 395-96 (same). By contrast, the deposits made under the terms of the IOLTA program have no net value; according to the District Court's express finding of fact in this case, they "could not reasonably be expected to earn interest for the client" over and above "the cost of establishing and maintaining the account." 873 F. Supp. at 4.

This direct conflict among the lower courts of last resort warrants plenary review by this Court. Indeed, on further proceedings in this case, six judges of the full Fifth Circuit Court of Appeals dissented from the order denying rehearing *en banc*, and Judge Benavides' separate dissenting opinion was joined by Chief Judge Politz, Judge Stewart, and Judge Parker.

Washington Legal Found. v. Texas Equal Access to Justice Found., 106 F.3d 640 (5th Cir. 1996). In that dissent, these judges emphasized the resulting split among the lower courts, stating that the panel decision "is an important one because it contradicts every other court in the country that has addressed this issue, including two of our sister circuits and a large number of state appellate courts." *Id.* at 641 (Benavides, J., dissenting).

The dissenting judges also sharply criticized the panel's reliance on the *Webb*'s decision. "A careful reading of *Webb*'s makes clear that the existence of interest proceeds *to which the depositors were entitled* was a prerequisite to the Court's decision." *Id.* at 643 (emphasis added). They pointed to language in the opinion recognizing that any proceeds from the interpleader fund would first have to be reduced by all "proper charges" before they could be distributed to lawful claimants, which strongly suggests that "the state law rule that 'interest follows principal' controls only when interest is earned on the principal or, in other words, when interest proceeds are available." *Id.* (discussing *Webb*'s, 449 U.S. at 161-65). They further criticized the panel's view that the alleged "two-part process" for assigning interest to a depositor was accurate either as a matter of normal banking practices or as a matter of law under the Takings Clause. *See* 106 F.3d at 643-44.

Moreover, the dissenting judges buttressed their argument by pointing to "the available remedy for plaintiffs whose property has been unconstitutionally taken." *Id.* at 644. "Such plaintiffs are entitled to just compensation, *i.e.*, the fair market value of their property. Because the fair market value of the earnings of IOLTA-eligible funds is \$0, the client would be entitled to nothing." *Id.* This point is significant because "applying Fifth Amendment protections to an asserted property interest that does not have any compensable value is not consistent with the purposes that underlie the Takings Clause." *Id.*

The foregoing discussion of the principal authorities thus shows that the split in the lower courts on the takings issues raised by state IOLTA programs is deep and irreconcilable. The disagreement permeates the very foundations of the conflicting legal analyses, including differing views about how to read this Court's *Webb*'s decision, about whether individual clients have a "property" right to the proceeds of IOLTA funds, and about whether such clients have any legitimate "investment-backed" expectation to those proceeds. At the same time, these conflicting decisions will inflict uncertainty and confusion upon the administrators of state IOLTA programs throughout the country, and the legal service providers who are their direct beneficiaries, if the Court does not grant plenary review to resolve the takings issues in this case.

II. WHETHER THE STATE IOLTA PROGRAMS CONSTITUTE A "TAKING" OF PROPERTY WITHOUT "JUST COMPENSATION" RAISES IMPORTANT CONSTITUTIONAL ISSUES THAT HAVE NOT BEEN, BUT SHOULD BE, DECIDED BY THIS COURT.

In his dissent from denial of rehearing *en banc*, Judge Benavides observed that the takings issue posed in this case "raises very difficult and interesting conceptual issues regarding the proper definition of property for fifth amendment purposes." 104 F.3d at 645-46 (Benavides, J., dissenting). This observation is undeniably correct, and provides yet another reason why the petition for certiorari should be granted here.

In the *Webb*'s case, the Court noted probable jurisdiction to decide "whether it is constitutional for a county to take as its own, under the authority of a state statute, the interest accruing on an interpleader fund deposited in the registry of the county court, when a fee, prescribed by another statute, is also charged for the clerk's services in receiving the fund into the registry."

449 U.S. at 155-56. The Court granted plenary review to determine that issue because the Florida Supreme Court's decision was judged to be in conflict with decisions rendered by the Texas and North Carolina Supreme Courts. *Id.* at 159. Although the Court gave no indication that the particular mechanisms of the interpleader fund at issue in that case derived from a uniform program that had been adopted nationwide, nonetheless the Court believed that the takings issue was sufficiently important to warrant a full review on the merits.

By comparison to *Webb*'s, the takings issues presented in this case clearly warrant the Court's consideration on the merits. The disagreement among lower courts of last resort is especially pronounced here, with the Fifth Circuit consciously disregarding decisions on the same constitutional issues that had been rendered by several state supreme courts and two federal courts of appeals. The Fifth Circuit's decision directly undercuts the Texas courts' approval of their own IOLTA program as legally valid, and appears to invalidate the same programs that are operating in Louisiana and Mississippi. State IOLTA programs have been implemented nationwide, and are of increasing importance to assuring the continued availability of legal services to those who cannot afford to hire a lawyer on their own. As Judge Benavides and the other dissenting judges noted, the panel's ruling below threatens "a primary source of funding for public interest legal organizations" at a time "when those organizations are already struggling for their lives financially." 106 F.3d at 641-42.

In addition, however, the conceptual issues involved here are of broader significance to the development of the Court's takings jurisprudence. The threshold issue in all such cases is whether the complaining party has a valid "property right" that has been "taken," which triggers the constitutional command that just compensation be made. Yet the *Webb*'s decision did not provide any broad guidance to the lower courts on this issue

in the important context of the administration of legal and judicial funds. On the contrary, the Court closed that opinion by emphasizing "the narrow circumstances of this case," and cautioning that its opinion should not be read to apply outside a situation where state law required the deposit of funds for protection against claims of creditors, "the deposited fund itself concededly is private," and a state statute authorized the clerk to charge a fee "for services rendered" that was distinct from any return accrued on the principal deposit. *Id.* at 164-65.⁵

This case presents the Court with the opportunity to define more clearly the issue of when courts should recognize a "taking" of property rights in the context of legal and judicial funds. Contrary to the view expressed by the panel below, the issue presented here is unlike the situation of a physical taking of tangible property. Under the terms of the IOLTA programs, the nominal or transitory nature of the deposited funds does not give rise to any "reasonable investment-backed expectation" that any net proceeds will be generated from their use. *Id.* at 161. The Court has stressed that such a "property right" must be grounded in "a legitimate claim of entitlement," which involves a strong element of reliance upon the asserted claim. *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). In *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984), for example, the Court held that even where a company has valid property rights in protecting its trade secrets, no "taking" occurs unless the required disclosure of such information interferes with any "reasonable investment-backed expectations." *Id.* at 1004-14.

Similarly, viewing this issue in terms of the formula that the Court has repeatedly employed to gauge whether a

⁵ These extensive caveats further call into question the ruling below, which construed *Webb*'s very broadly to stand for an across-the-board legal principle that interest must follow principal without regard to any of the particular circumstances of the funds deposited or the methods of administering those funds. See 94 F.3d at 1000-01.

governmental regulation of property constitutes a "taking," the lower courts would very likely benefit from further clarification about how this three-part test, first articulated in *Penn Central Transp. Co. v. New York*, 438 U.S. 104, 124 (1978), applies to the administration of legal and judicial funds. The First Circuit applied this test, as further developed in *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225 (1986), to IOLTA programs in the *Massachusetts Bar* case and held that there was no physical invasion of property rights under such programs, that their "economic impact" on individual clients is negligible, and that they do not interfere "with distinct investment-backed expectations." *Id.*, 993 F.2d at 974-76 (citing *Connolly* and *Penn Central*).

In addition, this case also presents the Court with an opportunity to clarify that whether such a property right exists at all must be bounded in part by whether the complaining party would be entitled to receive compensation for an infringement upon that right. Judge Benavides framed this principle in his dissent below when he noted that "the fair market value of the earnings of IOLTA-eligible funds is \$0," and suggested that "applying Fifth Amendment protections to an asserted property interest that does not have any compensable value is not consistent with the purposes that underlie the Takings Clause -- to compensate a property owner for the value of her property that was taken for public use." 106 F.3d at 644.

Judge Benavides' suggestion is consistent with the Court's prior decisions that have explored the meaning of the "just compensation" requirement. Justice Holmes long ago summarized the proper test under this component of the Takings Clause as an determination of "what has the owner lost, not what has the taker gained." *Boston Chamber of Commerce v. Boston*, 217 U.S. 189, 195 (1910). Moreover, in a series of decisions, the Court has held that when the government effects a taking of property, basic fairness dictates that the government

is not required to compensate the property owner for elements of the property's value that the government itself had created. *See, e.g., United States v. Fuller*, 409 U.S. 488 (1973) (value created by government's grant of a revocable permit to graze his animals on adjoining Federal lands); *United States ex rel. TVA v. Powelson*, 319 U.S. 266 (1943) (value created was business opportunity dependent on owner's privilege to use the state's power of eminent domain). If those same bounds are applied to the operation of state IOLTA programs, then any alleged "taking" of property would not be compensable because the individual client's funds are, by strict definition, incapable of generating any income net of administrative expenses, and any value derived from the funds is created solely by the operation of the IOLTA program itself.

The takings issues presented in this case thus involve important questions of federal constitutional law that have not been, but should be, settled by this Court.

CONCLUSION

For these reasons, as well as those stated by petitioners, the petition for a writ of certiorari should be granted.

Respectfully submitted,

RICHARD A. FRYE
CHESTER, WILLCOX & SAXBE
17 South High Street
Suite 900
Columbus, Ohio 43215
(614) 221-4000

RICHARD A. CORDRAY
Counsel of Record
4900 Grove City Road
Grove City, Ohio 43123
(614) 539-1661

Attorneys for the Amici Curiae

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No. 96-1578

In The
Supreme Court of the United States
October Term, 1996

—◆—
HON. THOMAS R. PHILLIPS, ET AL.,
Petitioners,
vs.

WASHINGTON LEGAL FOUNDATION, ET AL.,
Respondents.

—◆—
On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

—◆—
**BRIEF OF THE AMERICAN BAR ASSOCIATION
AS AMICUS CURIAE IN SUPPORT OF PETITIONERS**

—◆—
N. LEE COOPER
President
American Bar Association
KENNETH M. ELKINS*
BEVERLY V. GROUDINE
750 N. Lake Shore Drive
Chicago, Illinois 60611
312/988-5000

**Counsel of Record*

QUESTION PRESENTED

Amicus curiae, the American Bar Association (ABA), provides its perspective on the following question:

Does interest earned on client trust funds that lawyers hold in Interest on Lawyers' Trust Accounts (IOLTA) constitute a cognizable property interest of the client or lawyer for Fifth Amendment purposes despite the fundamental precept that such funds, absent an IOLTA program, could not earn interest for either?¹

¹ The amicus curiae will not, in this brief, address the constitutional issues raised by this question. Instead, based on its unique, national perspective, the amicus curiae will examine the divergence that the Fifth Circuit Court of Appeals' opinion of September 12, 1996 created among the circuits; the evolution of IOLTA in light of the judicial harmony that existed prior to the Fifth Circuit opinion; and the drain on judicial resources, the uncertainty created in the legal profession and the harmful effect on the delivery of civil legal services to indigents nationally that is likely to occur if the divergence is not expeditiously resolved.

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INTEREST OF THE AMERICAN BAR ASSOCIATION

With the consent of all parties to this litigation and upon filing letters of consent with the Clerk of the United States Supreme Court, the ABA respectfully submits this brief as amicus curiae in support of the petition for writ of certiorari.²

The ABA is a voluntary membership organization of the legal profession dedicated to the promotion of a fair and effective system for the administration of justice.³ Its membership includes approximately 342,000 lawyers.

Three of the twelve goals that the ABA has adopted reflect its interest in the matter before this Court:

- Goal I: To promote improvements in the American system of justice.
- Goal II: To promote meaningful access to legal representation and the American system of justice for all persons regardless of their economic or social condition.
- Goal IV: To increase public understanding of and respect for the law, the legal process and the role of the legal profession.

² Neither this brief nor the decision to file it should be interpreted to reflect the views of any judicial member of the American Bar Association. No inference should be drawn that any member of the Judicial Division Council has participated in the adoption of or endorsement of the positions in this brief. This brief was not circulated to any member of the Judicial Division Council prior to filing.

³ See, American Bar Association Constitution, Article 1, Sec. 1.2.

The ABA has been involved in IOLTA for almost two decades. The simple concept of pooling nominal, short-term client funds in lawyers' trust accounts to generate income, without loss to clients, for law-related public service activities, first appeared in the 1960s in Australia. Innovative efforts to adopt this type of program in Florida, California and Idaho during the 1970s prompted the ABA's interest.

By 1978, the ABA provided information on the development of American and foreign IOLTA programs to interested bar associations, legal services providers and others. In 1981, the ABA formed the Advisory Board and Task Force on Interest on Lawyer Trust Accounts, which reported to the ABA Board of Governors in 1982.⁴ In that same year, the ABA Standing Committee on Ethics and Professional Responsibility issued an opinion that examined the ethical implications of a lawyer's participation in an IOLTA program.⁵ The opinion concluded that it is ethically permissible for a lawyer to participate in a state-authorized IOLTA program.

Since then, the ABA has supported the creation of IOLTA programs in every state in the nation and has adopted three policy statements in support of IOLTA:

1. A 1983 resolution of the ABA Board of Governors approved the concept of state-authorized IOLTA programs and acknowledged the continuing need for

⁴ American Bar Association, *Report to the Board of Governors of the Advisory Board and Task Force on Interest on Lawyer Trust Accounts*, July 26, 1982.

⁵ ABA Formal Opinion 348 (1982).

additional funding for civil legal services to the poor and for other law-related public service activities. The resolution supported allocation of funds to reflect the needs and priorities of each jurisdiction.

2. A 1988 resolution of the ABA House of Delegates encouraged states to adopt or convert to a comprehensive IOLTA program, in which all lawyers who maintain client trust accounts would be required to participate.
3. A 1991 resolution of the ABA House of Delegates reaffirmed support for state IOLTA programs and admonished against the use of IOLTA revenues as a substitute for public funding of governmental obligations arising under the U.S. Constitution or other laws.

Today, IOLTA programs operate in 49 states and the District of Columbia.⁶ They are a critical part of an indigent civil legal services delivery system that has evolved throughout the United States over the past two decades. State IOLTA programs provide grants in support of equal access to justice through the provision of direct legal services, pro bono services, improvements in the administration of justice and law related education. Their importance has grown significantly in the last two years due to a 30 percent reduction in the budget of the Legal Services Corporation (LSC), the entity providing federal funding for legal services to the poor. As a result, IOLTA

⁶ In addition, the Indiana Supreme Court has approved IOLTA in concept, but the program is not yet operational.

programs fund an ever increasing share of civil legal services to the indigent.

The ABA created the Commission on IOLTA and the IOLTA Clearinghouse in 1986. Both monitor and provide information about the operation of IOLTA programs across the country. The ABA is therefore uniquely situated to provide this Court with the history of state IOLTA program development and a national perspective on the implications that this case may have on the ability of poor people to gain access to the nation's civil justice system if the Court does not quickly resolve the issues herein raised.⁷

ARGUMENT

- I. By holding that clients have a cognizable property interest in revenues that result from the operation of the Texas IOLTA rule, the United States Court of Appeals for the Fifth Circuit has created a conflict among the circuits and has contradicted every state supreme court that has ruled on this issue.

The United States Court of Appeals for the Fifth Circuit is the only court in the country to find that clients have a cognizable property interest in IOLTA revenues, disagreeing with both the First and Eleventh Circuits⁸

⁷ Although the Fifth Circuit remanded the case to the district court, this Court can rule in favor of Petitioners without the need for further factual findings.

⁸ *Washington Legal Foundation, et al. v. Massachusetts Bar Foundation, et al.*, 993 F.2d 962 (1st Cir. 1993); *Cone v. State Bar of*

and the seven state supreme courts that have explicitly considered the issue.⁹ In addition, forty-four of the fifty operational IOLTA programs in the United States, including the Texas program, were created by state supreme courts.¹⁰ These courts either explicitly or implicitly found that clients have no cognizable property interest in the interest that IOLTA accounts generate.¹¹ For the past sixteen

Florida, 819 F.2d 1002 (11th Cir.), cert. denied, 484 U.S. 917 (1987).

⁹ *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981); *Petition of Minnesota State Bar Association*, 332 N.W.2d 151 (Minn. 1982); *Petition of New Hampshire Bar Association*, 122 N.H. 971, 453 A.2d 1258 (1982); *Matter of Interest on Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *In the Matter of the Adoption of Amendments to CPR DR 9 102 IOLTA*, 102 Wash.2d 1101 (1984); *In the Matter of Interest on Lawyers' Trust Accounts*, 283 Ark. 252, 675 S.W.2d 355 (1984); *Petition by Massachusetts Bar Association*, 395 Mass. 1, 478 N.E.2d 715 (1985). In addition, the California Supreme Court refused to review a consistent decision of the California District Court of Appeals for the Fourth District. See, *Carroll v. State Bar of California*, 166 Cal. App.3d, 213 Cal. Rptr. 305 (Cal. App. 4th Dist.), cert. denied sub nom., *Chapman v. State Bar of California*, 474 U.S. 848 (1985). Although the Indiana Supreme Court, in an opinion on a petition to establish IOLTA by court rule, discussed constitutional aspects of the proposed rule, it did not rule on the constitutional issue. Instead, it rejected the petition because the program would have contravened the state's Rules of Professional Conduct. See, *Indiana State Bar Association's Petition*, 550 N.E.2d 311 (Ind. 1990).

¹⁰ In addition, the IOLTA program in the District of Columbia was created by the District of Columbia Court of Appeals.

¹¹ The IOLTA programs in the following states operate by authority of a state supreme court order: Alabama, Alaska, Arizona, Arkansas, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi,

years, IOLTA programs, with the participation and/or support of individual lawyers, bar associations, courts and legislatures, have relied on these decisions and rulings to fund such worthwhile law-related public service activities as the provision of civil legal services to those who cannot afford a lawyer.

The prior decisions on this issue share a common and common sense finding: a client whose money is placed in an IOLTA account loses nothing. Before the advent of Negotiable Order of Withdrawal (NOW) accounts, client funds generally were held in non-interest-bearing checking accounts.¹² A client benefitted only if the funds were placed in a separate, interest-bearing account because of their ability to produce income in excess of bank fees and administrative charges. Since it was common for client funds to be nominal in amount or held for a short time, however, lawyers routinely pooled the funds in one non-interest-bearing trust account, as it would have been prohibitively expensive to open and maintain a separate account for each client. Accordingly, the only parties that benefitted from these pooled accounts were the banks.¹³

Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming. The IOLTA rule in the District of Columbia was promulgated by an order of the District of Columbia Court of Appeals. The remaining five programs are legislative creations: California, Connecticut, Maryland, New York and Ohio.

¹² ABA Formal Opinion 348 (1982).

¹³ *Cone v. State Bar of Florida*, 819 F.2d 1002, 1005 (11th Cir.), cert. denied, 484 U.S. 917 (1987).

In the early 1970s, leaders in the legal profession began to examine the possibility of shifting the benefit from the financial institutions to the public. By 1976, after a five-year study, the governing boards of the Florida Bar and the Florida Bar Foundation approved the IOLTA program concept. That work culminated in the adoption of the first American IOLTA program in 1978.¹⁴ In February 1979, the National Conference of Chief Justices adopted a resolution endorsing the Florida program and recommending its introduction in other states.

The implementation of IOLTA throughout the United States did not become possible, however, until Congress passed 12 USC § 1832 in 1980. Commonly known as the Consumer Checking Account Equity Act, it allows financial institutions to pay interest on checking, or NOW, accounts. Five state legislatures, forty-four state supreme courts, including the Texas Supreme Court, and the District of Columbia Court of Appeals have taken advantage of 12 USC § 1832 to put the IOLTA concept into practice.

IOLTA rules either permit or require a lawyer, as fiduciary, to place nominal or short-term client funds (i.e., funds that before IOLTA would have been pooled in a

¹⁴ *In re Interest on Trust Accounts*, 356 So.2d 799 (Fla. 1978). At the time of this decision, Negotiable Order of Withdrawal (NOW) accounts, the vehicle through which IOLTA accounts earn interest, were approved for operation only in the New England states. At that time, although the Federal Reserve Board of Governors had recommended to Congress that such accounts be made available nationally, Congress had not yet acted. In its decision, the Florida Supreme Court acknowledged that an IOLTA program could not be implemented in Florida until NOW accounts became available in the state.

non-interest-bearing account) in a pooled NOW account. Each lawyer must first assess whether a client's funds are sufficient, or will be held long enough, to produce interest in excess of the bank fees and administrative charges associated with establishing and maintaining an interest-bearing account.¹⁵ IOLTA rules prohibit a participating lawyer from placing in an IOLTA account those client funds that, in the lawyer's best professional and fiduciary judgment, have the potential to generate net interest for the client's benefit. If, however, in the lawyer's judgment, the funds cannot do so, the participating lawyer deposits them in an IOLTA account. In such situations, the enabling state supreme court order or state statute authorizes participating financial institutions to remit the interest to the IOLTA program, which is eligible to be a NOW account beneficiary under 12 CFR § 204.130.¹⁶

IOLTA programs, therefore, comply with federal law and the ethical rules governing the legal profession. Lawyers, as fiduciaries, can maintain NOW accounts for nominal or short-term client funds that would not generate income for clients, because the recipient of the interest,

¹⁵ The following factors play a role in the lawyer's assessment: interest rates, available bank products, customary fees and administrative charges prevailing in a given location at a given point in time, and the lawyer's subjective judgment.

¹⁶ Every IOLTA program falls into one of the following categories, each of which is an eligible beneficiary under 12 CFR § 204.130: a bar foundation; an independent 501(c)(3) organization; or an extension or a special program of a state, a state's highest court, or a state bar association. A lawyer, as fiduciary, can maintain a NOW account only if the account's beneficiary is otherwise eligible under 12 CFR § 204.130. See, 12 CFR § 204.130(e).

the state IOLTA program, is always an entity that is otherwise eligible to maintain NOW accounts. The programs also satisfy lawyers' ethical and fiduciary duties to place client funds in a secure account where clients have on-demand access to their money.

After almost twenty years and numerous examinations and reaffirmations of IOLTA's fairness and constitutionality, the Fifth Circuit Court of Appeals' ruling is the first ever to cast substantial doubt on this concept. IOLTA, however, changes nothing vis-a-vis the client: only those client funds that **cannot** earn net interest for the client's benefit can be placed in IOLTA accounts. IOLTA does, however, change much in the lives of the indigent by providing funding for their access to the civil justice system.

II. The failure to resolve promptly the conflict among the circuits will have a negative national impact on the ability of indigents to gain access to the civil justice system, result in a drain on judicial resources and cause uncertainty in the legal profession.

Since its inception, IOLTA has been an important player in the funding of free legal services to persons unable to afford a lawyer. In recent years, its role has become increasingly critical. From the early 1980s to the present, the number of poor people in the United States has grown while federal funding for indigent civil legal services has diminished. In 1981, the budget for LSC was

\$321 million.¹⁷ After being reduced to \$241 million in 1982,¹⁸ the budget gradually increased to \$350 million in 1992,¹⁹ an amount that did not keep pace with inflation and rising costs over the intervening decade. Although funding rose to \$415 million in 1995,²⁰ the 1997 Congressional appropriation for LSC was only \$283 million.²¹

As a result, the organized bar has sought other funding sources in order to maintain a minimal level of service by the 281 LSC-funded programs. The vast majority of that additional funding has come from state IOLTA programs.²² In addition to providing a revenue source for LSC-funded programs, IOLTA provides funding to many other important activities, such as the provision of pro bono legal services, improvements in the administration of justice and law related education.

In its first year of operation (1981), the Florida IOLTA program generated revenues of \$1,084.²³ By 1991, however, with fifty IOLTA programs in operation and interest rates at their highest in recent history, income from interest on lawyers' trust accounts grew to \$152.7 million nationally.²⁴ As interest rates declined in the early-and

¹⁷ Legal Services Corporation, 1982-1983 Annual Report 59.

¹⁸ Ibid.

¹⁹ Legal Services Corporation, 1992 Annual Report 4.

²⁰ Legal Services Corporation, 1995 Annual Report 3.

²¹ See, Pub. L. No. 104-208 (1997).

²² Legal Services Corporation, *History of LSC, IOLTA, and Non-LSC Funding to Legal Services Programs*, 1994.

²³ ABA Commission on IOLTA, *Survey of State IOLTA Program Income*.

²⁴ Ibid.

mid-1990s, IOLTA revenues declined. Nevertheless, in 1995, IOLTA income was approximately \$96.4 million.²⁵

If the current conflict among the circuits remains unresolved, opponents of IOLTA likely will file lawsuits in other jurisdictions.²⁶ As each state has a program slightly different from the next, there will be an escalation of IOLTA litigation nationwide, which will force IOLTA programs to defend their structures. The litigation will occur at a time when the federal government has reduced funding for civil legal services to indigents, making other funding sources such as IOLTA more critical than ever. Given the importance of IOLTA nationally, the least productive use of its resources is to defend lawsuits that can be avoided if this Court accepts the petition for a writ of certiorari.

The likelihood of additional litigation being initiated on this issue also makes a quick resolution of this matter necessary to conserve judicial resources. With the uncertainty that the conflict among the three circuits creates, judicial resources in the remaining circuits will likely be called upon to examine IOLTA programs to determine if they pass constitutional muster. As a result, the principle of judicial economy requires a quick resolution of the conflict among the circuits on this issue.

²⁵ Ibid.

²⁶ Indeed, Respondent, Washington Legal Foundation, has filed at least one additional lawsuit against an IOLTA program since the Fifth Circuit rendered its decision. See, *Washington Legal Foundation, et al. v. Legal Foundation of Washington et al.*, Civil Action No. C97-0146Z (W. D. Wash. January 29, 1997).

Hundreds of thousands of lawyers, too, have an interest in a rapid resolution of this issue. They and their bar associations have promoted, supported and complied with IOLTA guidelines, believing that the program is both constitutional and ethically compelled, given lawyers' obligation to ensure that those who cannot afford legal representation receive it. Now, after sixteen years of participation, those lawyers are left not knowing whether their conduct, in fact, is proper. The interests of the legal profession, the judiciary and those who cannot afford access to this nation's civil justice system should persuade the Court to accept, as soon as possible, the petition for writ of certiorari in this matter.

CONCLUSION

State IOLTA programs play a critical role in the funding of indigent civil legal services nationally. After approximately two decades of judicial unanimity that clients are not deprived of property when a lawyer places their funds in an IOLTA account, the Fifth Circuit Court of Appeals has cast substantial doubt on this crucial funding source. A prolonged conflict among the circuits on this issue will result in a drain on judicial resources, confusion in the legal profession and diminished access to this nation's civil justice system for the indigent. For these reasons, the petition for writ of certiorari should be granted.

Dated: May 2, 1997

Respectfully submitted,

N. LEE COOPER

President

American Bar Association

KENNETH M. ELKINS*

BEVERLY V. GROUDINE

**Counsel of Record*

AUG 25 1997

CLERK

In The
Supreme Court of the United States

October Term, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALES,
HON. NATHAN L. HECHT, HON. JOHN CORNYN,
HON. CRAIG T. ENOCH, HON. ROSE SPECTOR,
HON. PRISCILLA OWEN, HON. JAMES A. BAKER,
HON. GREG ABBOTT, IN THEIR OFFICIAL CAPACITIES
AS JUSTICES OF THE TEXAS SUPREME COURT;
TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION;
AND W. FRANK NEWTON, IN HIS OFFICIAL
CAPACITY AS CHAIRMAN OF THE TEXAS EQUAL
ACCESS TO JUSTICE FOUNDATION,

v. *Petitioners,*

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

On Writ Of Certiorari To The United States
Court Of Appeals For The Fifth Circuit

JOINT APPENDIX

RICHARD A. SAMP*
DANIEL J. POPEO
WASHINGTON LEGAL
FOUNDATION
2009 Massachusetts
Avenue, N.W.
Washington, D.C. 20036
(202) 588-0302
*Attorneys for Respondent
Washington Legal Foundation*

MICHAEL J. MAZZONE
9 Greenway Plaza
Suite 2300
Houston, TX 77046
(713) 950-6001
Pro Se

**Counsel of Record*

DARRELL E. JORDAN*
BRITTAN L. BUCHANAN
DAVID J. SCHENCK
BETH W. BIVANS
HUGHES & LUCE, L.L.P.
1717 Main Street, Suite 2800
Dallas, TX 75201
(214) 939-5500
Attorneys for Petitioners
NANCY TREASE
Office of the Attorney General
of Texas
P.O. Box 12548, Capitol Station
Austin, TX 78711
(512) 475-4075
Attorneys for Petitioners

Petition For Certiorari Filed April 4, 1997
Certiorari Granted June 27, 1997

127PP

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RELEVANT DOCKET ENTRIES

2/7/94 Complaint filed in United States District Court for the Western District of Texas

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1/19/95 Opinion and Judgment of District Court

2/10/95 Notice of Appeal filed by Plaintiffs

9/12/96 Opinion and Judgment of Fifth Circuit

9/26/96 Suggestion for Rehearing *En Banc* and Petition for Panel Rehearing filed by Appellees

2/14/97 Suggestion for Rehearing *En Banc* and Petition for Panel Rehearing denied

4/4/97 Petition for a Writ of Certiorari filed

5/5/97 Cross-Petition for a Writ of Certiorari filed

6/27/97 Petition granted limiting question presented to Question One

6/27/97 Cross-Petition for a Writ of Certiorari denied

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL)
FOUNDATION,)
2009 Massachusetts Ave., NW)
Washington, DC 20036)
MICHAEL J. MAZZONE,)
2927 Georgetown)
Houston, TX 77005)
and)
WILLIAM R. SUMMERS,)
Plaintiffs,)
v.)
TEXAS EQUAL ACCESS TO)
JUSTICE FOUNDATION,)
400 West 15th St., Suite 712)
Austin, TX 78701)
W. FRANK NEWTON,)
Chairman,)
Texas Equal Access to Justice)
Foundation,)
400 West 15th St., Suite 712)
Austin, TX 78701)
THOMAS R. PHILLIPS, Chief)
Justice,)
Supreme Court of Texas,)
201 W. 14th Street)
Austin, TX 78701)

Civil Action No.
A 94 CA 081 JN
(Filed
Feb. 7, 1994)

RAUL A. GONZALEZ, Justice,)
Supreme Court of Texas,)
201 W. 14th Street)
Austin, TX 78701)
JACK HIGHTOWER, Justice,)
Supreme Court of Texas,)
201 W. 14th Street)
Austin, TX 78701)
NATHAN L. HECHT, Justice,)
Supreme Court of Texas,)
201 W. 14th Street)
Austin, TX 78701)
LLOYD DOGGETT, Justice,)
Supreme Court of Texas,)
201 W. 14th Street)
Austin, TX 78701)
JOHN CORNYN, Justice,)
Supreme Court of Texas,)
201 W. 14th Street)
Austin, TX 78701)
BOB GAMMAGE, Justice,)
Supreme Court of Texas,)
201 W. 14th Street)
Austin, TX 78701)
CRAIG T. ENOCH, Justice,)
Supreme Court of Texas,)
201 W. 14th Street)
Austin, TX 78701)
and)

ROSE SPECTOR, Justice,)
 Supreme Court of Texas,)
 201 W. 14th Street)
 Austin, TX 78701)
 Defendants.)
 _____)

COMPLAINT FOR INJUNCTIVE RELIEF

1. This is an action brought by a public interest law firm, an attorney licensed to practice law in the State of Texas, and a citizen of Texas to enjoin state officials from continuing to enforce Texas's IOLTA ("Interest on Lawyers' Trust Accounts") program.

2. Under the IOLTA program, Texas officials compel attorneys under certain circumstances to forward interest earned on funds being held by the attorneys for their clients, to a state-controlled entity.

3. Each of the Plaintiffs objects to this compelled taking and use of IOLTA trust accounts, in violation of their rights under the U.S. Constitution as guaranteed by the First and Fifth Amendments.

Jurisdiction

4. The Court has jurisdiction over this action under 28 U.S.C. § 1331, in that the action arises under the Constitution of the United States; and under 28 U.S.C. § 1343, in that the action seeks redress of the deprivation, under color of state law, of rights secured by the Constitution. Plaintiffs' right to judicial review of the actions complained of is secured by 42 U.S.C. § 1983.

Parties

5. Plaintiff WASHINGTON LEGAL FOUNDATION is a nonprofit public interest law and policy center based in Washington, DC with more than 100,000 members and supporters nationwide, including many within Texas. It devotes a substantial portion of its resources to protecting the speech and property rights of individuals from undue government interference. Among WLF's members are citizens of Texas who object to having their money used to support the Texas IOLTA program, and attorneys in Texas who object to being forced to place client trust funds into IOLTA accounts.

6. Plaintiff MICHAEL J. MAZZONE is a citizen of Texas and an attorney licensed to practice law in Texas. He is suing on behalf of himself and in his fiduciary capacity as trustee on behalf of his clients who have funds in his IOLTA trust account.

7. Plaintiff WILLIAM R. SUMMERS is a citizen of Texas. In the course of his business dealings, he has in the past engaged the services of attorneys and expects to continue to do so. SUMMERS has had his money placed into IOLTA trust accounts. Currently, a small amount of his money is in an IOLTA account and has been in that account since May 1993.

8. Defendant TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION is a nonprofit corporation established under the direction of the Supreme Court of Texas. Pursuant to rules established by the Supreme Court of Texas, all interest earned on IOLTA accounts is forwarded to the TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION, which in turns distributes the funds to other entities in

accordance with rules established by the Texas Supreme Court.

9. Defendant W. FRANK NEWTON is Chairman of the TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION. NEWTON is being sued in his official capacity.

10. Defendant THOMAS R. PHILLIPS is Chief Justice of the Supreme Court of Texas, the government body at whose direction the Texas IOLTA program was established. PHILLIPS is being sued in his official capacity.

11. Defendant RAUL A. GONZALEZ is a Justice of the Supreme Court of Texas. GONZALEZ is being sued in his official capacity.

12. Defendant JACK HIGHTOWER is a Justice of the Supreme Court of Texas. HIGHTOWER is being sued in his official capacity.

13. Defendant NATHAN L. HECHT is a Justice of the Supreme Court of Texas. HECHT is being sued in his official capacity.

14. Defendant LLOYD DOGGETT is a Justice of the Supreme Court of Texas. DOGGETT is being sued in his official capacity.

15. Defendant JOHN CORNYN is a Justice of the Supreme Court of Texas. CORNYN is being sued in his official capacity.

16. Defendant BOB GAMMAGE is a Justice of the Supreme Court of Texas. GAMMAGE is being sued in his official capacity.

17. Defendant CRAIG T. ENOCH is a Justice of the Supreme Court of Texas. ENOCH is being sued in his official capacity.

18. Defendant ROSE SPECTOR is a Justice of the Supreme Court of Texas. SPECTOR is being sued in her official capacity.

Statement of the Claim

19. By order effective May 9, 1984, the Supreme Court of Texas amended the State Bar Rules in order to create the Texas Equal Access to Justice Program (the "IOLTA Program"). The amendments, codified as Article XI of the State Bar Rules, provided that an attorney receiving client funds that were "nominal in amount" or were "reasonably anticipated to be held for a short period of time" was permitted to place the funds into an unsegregated interest-bearing bank account (an "IOLTA account") and to pay interest earned on those funds to a nonprofit corporation to be established by rules to be promulgated by the Supreme Court of Texas.

20. Article XI further provided that the nonprofit corporation was to be governed by a board of directors consisting of a chairman and twelve members. The chairman and six directors were to be appointed by the Supreme Court of Texas and the other six directors were to be appointed by the president of the State Bar of Texas.

21. In order to implement Article XI, the Supreme Court of Texas by order dated April 30, 1984 adopted its "Rules Governing the Operation of the Texas Equal

Access to Justice Program" (the "Rules"). The Rules provided, *inter alia*, that the nonprofit corporation whose creation was mandated by Article XI was to be the TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION.

22. Consistent with Article XI, the Rules specified that funds forwarded to the TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION from IOLTA accounts were to be awarded as grants solely to nonprofit organizations that "have as a primary purpose the delivery of legal services to low income persons." The Rules specified certain uses to which such grant money could not be put, including class action suits and lobbying for or against any candidate or issue.

23. During the first four years of operation of the IOLTA program (1985-1988), funds forwarded from IOLTA accounts to the TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION never exceeded \$1 million per year.

24. On November 11, 1988, the Board of Trustees of the TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION voted unanimously to recommend to the Supreme Court of Texas conversion from a voluntary to a mandatory IOLTA program in Texas.

25. On December 13, 1988, the Supreme Court of Texas amended Article XI and the Rules in order to make participation in the Texas IOLTA program mandatory. Pursuant to the amended Article XI and the amended Rules, attorneys in Texas who "hold client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time" *must* place the funds in an unsegregated interest bearing account, with interest earned thereon to be paid to the TEXAS EQUAL ACCESS

TO JUSTICE FOUNDATION. Attorneys and their clients are not permitted to place such funds into a non-interest-bearing account. Copies of the most recent versions of Article XI and the Rules are attached hereto as Exhibits A and B, respectively.

26. The amendments to Article XI and the Rules were adopted without following the state-law procedures for amending rules governing the State Bar, set forth in the State Bar Act, Vernon's Tex. Stat. Ann. Government Code § 81.024. Those procedures include a requirement that no amendment is valid unless approved by a vote of at least 51% of the registered members of the State Bar.

27. All attorneys licensed by the Texas Supreme Court to practice law in Texas annually must provide evidence to the TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION that they are in compliance with the requirements of Article XI and the Rules. Rule 24.

28. The switch from a voluntary to a mandatory IOLTA program became effective as of July 1, 1989. As a result of that switch, interest income generated by the Texas IOLTA program has increased ten-fold - to as much as \$10 million per year in recent years.

29. Many of the organizations to which the TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION provides grant funds (hereinafter, the "Recipient Organizations") use those funds to support litigation and other causes to which some citizens of Texas object for political or ideological reasons. As just one example, the Lawyers Committee for Civil Rights - an organization that has long advocated various "liberal" causes such as expansion of anti-discrimination rights of action - has been a regular

recipient of TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION grant funds. The Lawyers Committee for Civil Rights has used such funds to litigate for, *inter alia*, the expansion of rights of undocumented aliens. Some citizens of Texas, including some members of WLF, oppose the expansion of legal rights for such individuals and thus object to such litigation on political and/or ideological grounds. As another example, some of the Recipient Organizations have engaged in litigation over the drawing of electoral districts. Some citizens of Texas, including some members of WLF, object on political and/or ideological grounds to any such litigation, believing that decisions regarding electoral districts ought to be made by the executive and legislative branches of government.

30. In accordance with Article XI and the Rules, Plaintiff MAZZONE maintains an IOLTA account into which he regularly places client trust funds that either are nominal in amount or are reasonably anticipated to be held for a short period of time. Plaintiff MAZZONE has determined from experience that as a practical matter he cannot operate his law practice without collecting client funds that either are nominal in amount or are reasonably anticipated to be held for a short period of time, and that he cannot practicably set up a separate interest-bearing account for each such client. Accordingly, he has no choice but to place such funds into his IOLTA account.

31. Plaintiff MAZZONE holds title to such funds as trustee for the clients who have given him the funds for their own benefit. As trustee of the clients' funds, he is in a fiduciary relationship with his clients. His fiduciary duties to his clients include a duty to act solely in the interest of and on behalf of his clients as to matters

relating to the administration of the clients' trusts and as to matters relating to the proper representation of the interests of his clients.

32. Each of Plaintiff MAZZONE's clients whose funds he places in his IOLTA account has a beneficial interest in such funds, which interest includes (but is not limited to) the right to determine who, if anyone, should benefit from any income generated by the funds and the right to determine whether trust funds should generate any income at all. Each client's beneficial interest in an IOLTA account is itself an interest in property.

33. Plaintiff MAZZONE objects to some of the uses to which Recipient Organizations are putting IOLTA grant money and thus objects to being forced to associate with the Recipient Organizations by depositing client trust funds into his IOLTA account. Plaintiff MAZZONE further believes that he is being prevented from fully carrying out his fiduciary responsibilities to his clients by not being permitted to give his clients the option of designating that their trust funds not be placed into his IOLTA account.

34. Plaintiff SUMMERS is a businessman whose work requires him to make regular use of the services of attorneys. In the course of his dealings with attorneys, he has been required to place in trust with the attorneys funds that are nominal in amount or that are reasonably anticipated to be held for a short period of time, and he expects that he will be required to do so again in the future.

35. In May 1993, Plaintiff SUMMERS was sued in connection with one of his business ventures and retained

an attorney to represent him in connection with that litigation. In order to retain his attorney, he was required to make a small retainer payment to the attorney. The litigation is on-going, and his attorney continues to hold the retainer. Plaintiff SUMMERS recently learned that his retainer is being held in an IOLTA account and thus is generating interest to support the IOLTA program.

36. Plaintiff SUMMERS objected to his attorney that he did not wish his retainer to be held in an IOLTA account, because he did not wish to support the Texas IOLTA program. However, his attorney informed him that the attorney had no choice under Article XI and the Rules but to hold the retainer in the IOLTA account, because it was the attorney's good-faith belief that the retainer was "nominal in amount" and would not generate sufficient interest if maintained in a separate account to cover the costs of maintaining such an account.

37. Plaintiff SUMMERS objects to some of the uses to which Recipient Organizations are putting IOLTA grant funds and thus objects to being forced to associate with the Recipient Organizations by having the income generated from his funds used to finance the Recipient Organizations.

38. Any interest income derived from Plaintiff SUMMERS's funds rightfully belongs to him. He objects to anyone other than himself receiving the interest derived from those funds.

39. Plaintiff WASHINGTON LEGAL FOUNDATION (WLF) is a membership organization whose members include Texas citizens who, like Plaintiff SUMMERS, have had and/or are likely in the future to have funds placed

into IOLTA accounts. Those members do not wish to be associated in that manner with Recipient Organizations and do not wish interest on their funds to go to anyone but themselves. Other WLF members include Texas attorneys, like Plaintiff MAZZONE, who find that in order to maintain their law practices they must place funds into IOLTA accounts but who object to being forced in that manner to associate with the Recipient Organizations, and who believe that they are being prevented from carrying out their fiduciary duties to their clients by not being permitted to give their clients the option of placing into non-interest-bearing accounts funds that are nominal in amount or are reasonably anticipated to be held for a short period of time.

40. On January 16, 1992, WLF filed a petition with the Board of Directors of the State Bar of Texas that, *inter alia*, asked the Board of Directors to recommend to the Supreme Court of Texas that the Texas IOLTA program be changed such that no client funds would be placed into an IOLTA account until after the client's informed consent had been obtained. WLF forwarded a copy of that petition to the Supreme Court of Texas. WLF received a July 23, 1993 letter (attached hereto as Exhibit C) from the State Bar's Texas Disciplinary Rules of Professional Conduct Committee, informing WLF that "the Committee determined, after discussion, to take no action" on the petition.

41. Defendant TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION is empowered under the Rules to notify the State Bar of Texas of the names of Texas attorneys who are not in full compliance with IOLTA program requirements as established by Article XI and the Rules.

Rule 24. The State Bar of Texas then notifies the attorneys so named, and attorneys who fail to come into compliance within 30 days of such notice are liable for immediate suspension of their license to practice law by the Supreme Court of Texas.

COUNT I
(First Amendment)

42. Plaintiffs incorporate herein by reference the allegations of Paragraphs 1 through 41.

43. The forced collection and use, under color of state law, of interest generated from funds belonging to Plaintiff SUMMERS and/or belonging to similarly-situated members of Plaintiff WLF, despite their objections to some of the uses to which that interest is put, deprives Plaintiff SUMMERS and members of Plaintiff WLF of their rights to freedom of speech and association guaranteed by the First Amendment to the U.S. Constitution.

44. The forced collection and use, under color of state law, or [sic] interest generated from trust funds being held in Plaintiff MAZZONE's IOLTA account and/or being held in the IOLTA accounts of similarly-situated members of WLF, despite their objections to some of the uses to which that interest is being put, deprives Plaintiff MAZZONE and members of Plaintiff WLF of their rights to freedom of speech and association guaranteed by the First Amendment to the U.S. Constitution.

COUNT II
(Fifth Amendment)

45. Plaintiffs incorporate herein by reference the allegations of Paragraphs 1 through 41.

46. The Fifth Amendment to the U.S. Constitution guarantees that private property shall not be taken for public use, without just compensation. The taking, under color of state law, of the interest earned on Plaintiff SUMMERS's funds placed into IOLTA accounts and on the funds of similarly-situated members of WLF placed into IOLTA accounts, constitutes an illegal taking of property belonging to them, in violation of the Fifth Amendment to the U.S. Constitution.

47. The taking, under color of state law, of the interest earned on funds placed into Plaintiff MAZZONE's IOLTA account and on funds placed into the IOLTA accounts of similarly-situated WLF members, constitutes an illegal taking of the property of the clients of Plaintiff MAZZONE and of similarly-situated WLF members, in violation of the Fifth Amendment to the U.S. Constitution.

COUNT III
(Fifth Amendment)

48. Plaintiffs hereby incorporate by reference the allegations of Paragraphs 1 through 41.

49. Defendants' taking of the equitable or beneficial interest in (use of) client funds, under color of state law, by requiring their placement into IOLTA accounts, constitutes an illegal taking of the beneficial use of those funds,

in violation of the Fifth Amendment to the U.S. Constitution.

WHEREFORE, Plaintiffs respectfully request the following relief:

(1) Enter judgment requiring Defendants TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION and NEWTON to refund the full amount of interest earned on Plaintiffs' money placed into IOLTA trust accounts, plus interest.

(2) Enter judgment declaring Article XI of the State Bar Rules and the Rules Governing the Operation of the Texas Equal Access to Justice Program void as an unconstitutional deprivation of Plaintiffs' rights under the First and Fifth Amendments to the U.S. Constitution, insofar as they *require* attorneys to place certain client funds into IOLTA trust accounts.

(3) Permanently enjoin Defendants TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION and NEWTON from compiling a list of attorneys who fail to comply with the requirements of Article XI and the Rules, and from transmitting any such list to the State Bar of Texas.

(4) Permanently enjoin Defendants members of the Supreme Court of Texas from:

- (a) adopting any rules that purport to require attorneys, as a condition for practicing law in Texas, to handle client trust funds in a manner designed to ensure that interest on those funds will accrue to anyone not designated by the client;

- (b) taking disciplinary action against any attorney for failing to place client trust funds into an IOLTA account.

(5) Award Plaintiffs the costs of this action, including attorney fees as provided for by 42 U.S.C. § 1988.

(6) Award such other relief as the Court may deem just.

Respectfully submitted,

/s/ Steven W. Smith
Steven W. Smith
 Texas SBN 18685873
 3608 Grooms St.
 Austin, TX 78705
 (512) 322-0347
 (512) 322-0347 (FAX)

/s/ Michael J. Mazzone/
RAS
 Michael J. Mazzone
 Texas SBN 13313000
 2927 Georgetown
 Houston, TX 77005
 (713) 940-6001
 (713) 940-6099 (FAX)
 Pro Se
 Counsel for
 Plaintiff Mazzone

/s/ Richard A. Samp
Daniel J. Popeo
 Richard A. Samp
 WASHINGTON
 LEGAL
 FOUNDATION
 2009 Massachusetts
 Ave, NW
 Washington, DC 20036
 (202) 588-0302
 (202) 588-0386 (FAX)
 Counsel for Plaintiffs
 Summers and WLF

Dated: February 8, 1994

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL §
FOUNDATION, MICHAEL J. §
MAZZONE, and WILLIAM R. §
SUMMERS §
VS. §
TEXAS EQUAL ACCESS TO §
JUSTICE FOUNDATION, W. §
FRANK NEWTON, THOMAS R. §
PHILLIPS, RAUL A. §
GONZALEZ, JACK HIGHTOWER, §
NATHAN L. HECHT, LLOYD §
DOGGETT, JOHN CORNYN, §
BOB GAMMAGE, CRAIG T. §
ENOCH and ROSE SPECTOR. §

CIVIL NO.
A-94-CA-081 JN

ORDER

Before the Court is the Motion to Dismiss filed by Defendants Thomas Phillips, Raul Gonzalez, Jack Hightower, Nathan Hecht, Lloyd Doggett, John Cornyn, Bob Gammage, Craig Enoch, and Rose Spector ("the Supreme Court Defendants"), the Plaintiffs' Response, and the Supreme Court Defendants' Reply to Plaintiffs' Response. Having reviewed these pleadings as well as the relevant law, the Court finds that the Supreme Court Defendants' Motion to Dismiss this action on the basis of the Plaintiffs' lack of standing should be DENIED.¹

¹ This Order expresses no opinion as to the merits of the Motion to Dismiss filed by the Texas Equal Access to Justice

The Plaintiffs in this action are the Washington Legal Foundation, a self-described non-profit public interest law and policy center, Michael Mazzone, a Texas resident and attorney licensed to practice by the Texas Bar, and William Summers, a Texas resident and consumer of legal services rendered by members of the Texas Bar. The Plaintiffs have filed this action claiming that the Texas IOLTA ("Interest on Lawyers' Trust Accounts") Program violates their rights under the First and Fifth Amendments of the United States Constitution. In addition to a declaratory judgment finding the IOLTA Program unconstitutional, the Plaintiffs seek injunctive relief prohibiting mandatory participation in the IOLTA Program, a return of the full amount of interest earned on Plaintiffs' money placed in IOLTA trust accounts, and an award of costs and attorneys' fees.

TEXAS' IOLTA PROGRAM

Article XI of the Rules of the State Bar of Texas establish the Texas Equal Access to Justice Program ("the IOLTA Program"). Under this program, an attorney receiving client funds that are "nominal in amount" or "reasonably anticipated to be held for a short period of time" is required to place the funds in an unsegregated interest-bearing bank account. *See* State Bar Rules Governing Operation of Equal Access to Justice Program Rule 6 (*reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G

Foundation and W. Frank Newton, in which the Defendants move to dismiss this action on the grounds that the Plaintiffs have failed to state a claim upon which relief can be granted.

app. (Vernon 1988)). More specifically, the only funds eligible for the IOLTA Program are those which

could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client. *Id.*

Interest earned from IOLTA accounts is to be paid to the Texas Equal Access to Justice Foundation, a non-profit corporation. *Id.* Rule 9. The Foundation is charged with administering these funds, awarding them as grants to non-profit organizations that have a primary purpose of delivering legal services to low income persons. *Id.* Rules 10-12. Originally, the Texas IOLTA program was voluntary. However, in 1988, the Texas Supreme Court entered an order amending the State Bar Rules and converting the voluntary IOLTA program into the mandatory program presently in operation. *Id.*

ARTICLE III STANDING

The Plaintiffs raise two constitutional claims. First, they allege that the IOLTA Program effects a taking of the interest generated by the IOLTA-eligible funds, in violation of the Fifth Amendment. Second, they allege that the use of the interest proceeds to fund certain organizations violates their rights of freedom of association under the First Amendment. The Supreme Court Defendants have moved for dismissal of the Plaintiffs' complaint pursuant to Fed. R. Civ. P. 12(b)(1), alleging a lack of subject matter

jurisdiction due to the Plaintiffs' lack of standing to bring this action.

As a threshold matter in every federal case, the Court must determine whether the Plaintiffs have standing under Article III of the Constitution to bring their action. *Bender v. Williamsport Area School District*, 475 U.S. 534, 541, 106 S.Ct. 1326, 1331 (1986). Article III limits the federal judiciary's decisional authority to "cases" and "controversies." *Sierra Club v. Babbitt*, 995 F.2d 571, 574 (5th Cir. 1993). "A case or controversy does not exist unless the person who asks the court for a decision has 'standing' to do so, the elements of which are injury, causation, and redressability." *Id.* (citing *Lujan v. Defenders of Wildlife*, ___ U.S. ___, 112 S.Ct. 2130, 2136 (1992)). Regarding the first element, a plaintiff must "clearly demonstrate that he has suffered an 'injury in fact[]' " which means an "injury to himself that is 'distinct and palpable,' . . . as opposed to merely '(a)bstract,' . . . and the alleged harm must be actual or imminent, not 'conjectural' or 'hypothetical.'" *Whitmore v. Arkansas*, 495 U.S. 149, 155 110 S.Ct. 1717, 1723 (1990) (citations omitted). Second, the claimant must allege facts which show "that the injury 'fairly can be traced to the challenged action.'" *Id.* (citations omitted). Third, the plaintiff must show that the injury may be redressed by a favorable decision of the court granting the relief sought. *Id.*; *Defenders of Wildlife*, ___ U.S. at ___, 112 S.Ct. at 2136. The Plaintiffs bear the burden of establishing each of these elements. *Defenders of Wildlife*, ___ U.S. at ___, 112 S.Ct. at 2136; *FW/PBS, Inc. v. Dallas*, 493 U.S. 215, 231, 110 S.Ct. 596, 608 (1990).

"(A)t an irreducible minimum, Art. III requires the party who invokes the court's authority to 'show that he

personally suffered some actual or threatened injury as a result of the putatively illegal conduct of the defendant." *Valley Forge Christian College v. Americans United for Church and State, Inc.*, 454 U.S. 464, 102 S.Ct. 752 (1982) (citing *Gladstone, Realtors v. Village of Bellwood*, 441 U.S. 91, 99, 99 S.Ct. 1601, 1607 (1979)). It is also elementary that a plaintiff cannot assert the rights or interests of third parties. See, e.g., *Warth v. Seldin*, 422 U.S. 490, 499, 95 S.Ct. 2197, 2205 (1975).

For purposes of ruling on the motion to dismiss, the Court must accept as true all material allegations contained in the Plaintiffs' complaint, and must construe the complaint in favor of the complaining party. *Warth*, 422 U.S. at 501, 95 S.Ct. at 2206 (1975); *Cramer v. Skinner*, 931 F.2d 1020, 1025 (5th Cir.), cert. denied ___ U.S. ___, 112 S.Ct. 298 (1991). However, on motions to dismiss, the court is not required to accept legal conclusions either alleged or inferred from pleaded facts. *Kaiser Aluminum & Chem. Sales, Inc. v. Avondale Shipyards, Inc.*, 677 F.2d 1045, 1050 (5th Cir. 1982) cert. denied 459 U.S. 1105, 103 S.Ct. 729 (1983).

As the Plaintiffs have correctly noted, because an adjudication of the question of standing is not an adjudication on the merits, the Court must assume that the conduct which the Plaintiffs complain of is unconstitutional. *Cramer*, 931 F.2d at 1025 (citing *Warth*, 422 U.S. at 502, 95 S.Ct. at 2207). However, the Plaintiffs must nevertheless "allege and show that they personally have been injured. . . . Unless these (plaintiffs) can . . . demonstrate the requisite controversy between themselves personally and the respondents, 'none may seek relief on behalf of himself or any other member of the class.' "

Warth, 422 U.S. at 502, 95 S.Ct. at 2207. The Court's task then is to determine whether each of the Plaintiff's have standing to bring this cause of action in light of the aforementioned considerations.

Standing of Plaintiff Mazzone

Plaintiff Mazzone is an attorney who practices in the State of Texas. Mazzone maintains that as a Texas attorney who is bound by the Texas mandatory IOLTA program, he is being forced to associate with the organizations that receive grants from TEAJF. Some of these recipient organizations offend Plaintiff Mazzone's political and ideological beliefs.² Plaintiff Mazzone further maintains that he is being prevented from fully carrying out his fiduciary duties to his clients by not being able to give them the option of designating that their trust funds not be placed into his IOLTA account. Plaintiff Mazzone claims that his First Amendment rights are violated by the mandatory IOLTA program in that he is being forced to associate with organizations that are contrary to his political and ideological beliefs. Finally, Mazzone claims that his clients' rights under the Fifth Amendment are being infringed, and that, as the trustee

² As examples, Mazzone and the other Plaintiffs state that a portion of IOLTA grant funds go to the Lawyers Committee for Civil Rights, an organization the Plaintiffs claim have advocated various "liberal" causes such as the expansion of anti-discrimination causes of action, and the expansion of rights for undocumented aliens. The Plaintiff [sic] also allege that IOLTA funds have been directed to organizations involved in litigation relating to the drawing of boundaries of electoral districts.

of his clients' funds, he is entitled to represent them in this action.

The Court finds that Plaintiff Mazzone has adequately alleged injury sufficient to confer standing and to vest the Court with jurisdiction. Mazzone alleges that State Bar rules compel him to participate in the IOLTA program, and therefore he is forced to associate with IOLTA-funded organizations which offend his political and ideological beliefs. Further, Mazzone states that the mandatory nature of the IOLTA program forces him to choose between acting contrary to his political and ideological beliefs or violating Article XI of the State Bar Rules, thereby risking disciplinary sanctions or possibly disbarment. Without addressing the merits of Mazzone's claims, the Court finds that Mazzone has alleged an injury, namely an impingement-upon his First Amendment rights, which may be remedied by the requested relief, namely declaratory and injunctive remedies.³ Hence, Mazzone's allegations are sufficient to provide him with standing to raise his First Amendment claims.⁴

³ Mazzone's claim that he has standing to bring claims on behalf of his clients is somewhat more troubling. It is well-settled that, generally, a plaintiff must assert its own legal rights, without resting its claim for relief on the rights or interests of third parties. See, e.g., *Warth v. Seldin*, 422 U.S. at 499, 95 S.Ct. at 2205. However, since the Court finds *infra* that Plaintiff Summers (Mazzone's client) has standing to sue in his own right, this issue need not be addressed.

⁴ The Supreme Court Defendants argue that since the First Circuit has determined that the Massachusetts IOLTA program does not burden protected speech and is not forced association in violation of the First Amendment, Mazzone lacks standing "as a matter of law." See *Washington Legal Foundation v.*

Standing of Plaintiff Summers

Plaintiff Summers alleges that he makes regular use of the services of attorneys practicing in Texas, and that he has paid to his attorneys funds that have been placed in IOLTA accounts. Summers claims that the IOLTA Program collects and uses the interest generated by his funds for political and ideological causes he opposes, thereby depriving him of his rights of freedom of speech and association in violation of the First Amendment. Summers further claims that the IOLTA Program constitutes a taking of the beneficial use of those funds, in violation of the Fifth Amendment. These allegations, taken as true for the limited purposes of Fed. R. Civ. P. 12(b)(1), clearly state an injury to Summers, traceable to the Texas IOLTA Program, which may be remedied by the relief sought from this Court. Accordingly, the Court finds that Summers has standing to maintain his claims made in this action.

Standing of Plaintiff Washington Legal Foundation

For an organization to have standing to assert the interests of its members as a "representational plaintiff" requires a showing by the organization that

Massachusetts Bar Foundation, 993 F.2d 962 (1st Cir. 1993). The Supreme Court Defendants have confused standing questions with defenses on the merits. While the First Circuit's opinion may shed light on the merits of both the Plaintiffs' claims and defenses raised by the Defendants, it does not, in itself, pose as a bar to Plaintiff Mazzone's standing. See, e.g., *Hill v. City of Houston*, 764 F.2d 1156, 1159 (5th Cir. 1985), *cert. denied* 483 U.S. 1001, 107 S.Ct. 3222 (1987) (Plaintiff's standing to litigate constitutionality of ordinance should not be confused with apparent merit or lack of merit in plaintiff's challenge).

- (a) its members would otherwise have standing to sue in their own right;
- (b) the interests it seeks to protect are germane to the organization's purpose; and
- (c) neither the claim asserted nor the relief sought requires the participation of individual members in the lawsuit.

Save Our Community v. U.S. Environmental Protection Agency, 971 F.2d 1155, 1160 (5th Cir. 1992).

Both Plaintiffs Mazzone and Summers are alleged to be members of Plaintiff Washington Legal Foundation. As determined above, both Plaintiffs Mazzone and Summers have standing to sue in their own right. Thus, the first of the above-named factors is satisfied.

In its Complaint, Washington Legal Foundation states that it is a "nonprofit public interest law and policy center" which "devotes a substantial portion of its resources to protecting the speech and property rights of individuals from undue government interference." The Complaint specifically alleges that the IOLTA Program deprives Plaintiffs Mazzone and Summers and members of Plaintiff Washington Legal Foundation "of their rights to freedom of speech and association guaranteed by the First Amendment to the U.S. Constitution." Thus, it is clear that the interests Plaintiff Washington Legal Foundation seeks to protect are germane to its purposes as an organization, thereby satisfying the second requirement for representational standing.

Finally, there is no indication that the claims asserted or relief requested requires the participation of individual members in the lawsuit (beyond the extent to which

members Summers and Mazzone are already taking part). The Supreme Court Defendants argue that, since the Plaintiffs in part seek a return of the interest generated by funds owned or deposited by the two individual Plaintiffs in this suit, Washington Legal Foundation must be denied standing according to the dictates of *Warth v. Seldin*. In *Warth v. Seldin*, the Supreme Court held that an organizational plaintiff lacks standing to seek relief for damages for alleged injuries to its members, where it does not allege any monetary injury to itself, nor any assignment of the damages claims of its members, and where any injury that may have been suffered is peculiar in both fact and extent to the individual member of the organization. *Warth*, 422 U.S. at 515-16, 95 S.Ct. at 2213-14. Such is not the case here. Under *Warth*, it is proper for an organizational plaintiff to seek declaratory, injunctive or other form of prospective relief, where such relief will be reasonably anticipated to inure to the benefit of the associations members. *Id.* This is the type of relief sought by Plaintiff Washington Legal Foundation in its Complaint. The only relief requested in the Complaint that requires individual participation and proof by Plaintiff Washington Legal Foundation's members is Mazzone's and Summers' request for a return of their interest. This obviously fails to be a bar to Plaintiff Washington Legal Foundation's standing, as these Plaintiff's are participating individually in this action. Therefore, the third prerequisite for representational standing is met.

Based on the foregoing, the Court finds that the Plaintiffs have standing to bring this action, and the

Court has jurisdiction to rule on the merits of their claims.

THEREFORE, IT IS ORDERED that the Motion to Dismiss filed by Defendants Thomas Phillips, Raul Gonzalez, Jack Hightower, Nathan Hecht, Lloyd Doggett, John Cornyn, Bob Gammage, Craig Enoch, and Rose Spector is hereby DENIED.

SIGNED this 21st day of September, 1994

/s/ James R. Nowlin
JAMES R. NOWLIN
UNITED STATES DISTRICT
JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL §
FOUNDATION, MICHAEL J. §
MAZZONE, and WILLIAM R. §
SUMMERS §

VS. §

TEXAS EQUAL ACCESS TO §
JUSTICE FOUNDATION, W. §
FRANK NEWTON, THOMAS R. §
PHILLIPS, RAUL A. GONZALEZ, §
JACK HIGHTOWER, NATHAN §
L. HECHT, LLOYD DOGGETT, §
JOHN CORNYN, BOB §
GAMMAGE, CRAIG T. ENOCH §
and ROSE SPECTOR. §

CIVIL NO.
A-94-CA-081 JN

ORDER

(Filed Oct. 19, 1994)

Before the Court are the Defendants' Motions to Dismiss, the Plaintiffs' Responses, and the Defendants' Reply to the Plaintiffs' Responses. A hearing was held regarding the aforementioned pleadings on September 14, 1994. Supplemental briefs were filed by the parties following that hearing. Having reviewed the record in this cause of action, as well as the arguments of counsel and the relevant law, the Court finds that the Defendants' Motion to Dismiss should be DENIED.

The Plaintiffs have filed this action claiming that the Texas IOLTA ("Interest on Lawyers' Trust Accounts")

Program violates the First and Fifth Amendments of the United States Constitution. The Texas IOLTA Program requires an attorney receiving client funds that are "nominal in amount" or "reasonably anticipated to be held for a short period of time" to place such funds in an unsegregated interest-bearing bank account. See State Bar Rules Governing Operation of Equal Access to Justice Program Rule 6 (*reprinted in* Tex. Gov't Code Ann., tit 2, subtit. G app. (Vernon 1988)). Interest earned from these pooled IOLTA accounts is to be paid to the Texas Equal Access to Justice Foundation, a non-profit corporation. *Id.*, Rule 9. The Foundation is charged with administering these funds, awarding them as grants to non-profit organizations that have a primary purpose of delivering legal services to low income persons. *Id.*, Rules 10-12. The Plaintiffs allege that the Texas IOLTA Program violate the Constitution in at least two ways. First, they claim that the forced collection and use of the interest generated by client funds under the IOLTA Program effects a taking in violation of the Fifth Amendment. The Plaintiffs further claim that the forced use of interest generated by client funds to finance groups whose purposes they find objectionable constitutes compelled speech in violation of the First Amendment.

The Defendants have moved to dismiss the Plaintiffs' claims on the grounds that the Plaintiffs have failed to allege cognizable Fifth and First Amendment claims. When considering a motion to dismiss for failure to state a claim, the Court must take the factual allegations of the complaint as true and resolve any ambiguities or doubts regarding the sufficiency of the claim in favor of the plaintiff. *Fernandez-Montes v. Allied Pilots Ass'n*, 987 F.2d

278, 284 (5th Cir. 1993). Dismissal is inappropriate unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. *Conley v. Gibson*, 355 U.S. 41, 47-48, 78 S.Ct. 99, 102-03 (1957); *Colle v. Brazos County, Texas*, 981 F.2d 237, 243 (5th Cir. 1993).

Given the high threshold for granting a motion to dismiss, and having reviewed the record in this case, the arguments of counsel, and the applicable law, the Court finds that the Plaintiffs have stated claims under both the First and Fifth Amendment that are sufficient to withstand the Defendants' Motion to Dismiss. While there is non-binding authority that has rejected similar challenges to IOLTA programs in effect in other jurisdictions,¹ the Court cannot conclude that the Plaintiffs' claims are entirely foreclosed or merit dismissal at this early stage.

ACCORDINGLY, IT IS ORDERED that the Motions to Dismiss filed by the Defendants in this cause of action are hereby DENIED.

SIGNED this 18th day of October, 1994.

/s/ James R. Nowlin
JAMES R. NOWLIN
UNITED STATES DISTRICT
JUDGE

¹ See, e.g., *Cone v. State Bar of Florida*, 819 F.2d 1002, 1004 (11th Cir.), cert. denied 484 U.S. 917, 108 S.Ct. 268 (1987); *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962, 975-76 (1st Cir. 1993).

THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL §
FOUNDATION, ET AL., §
v. § CIVIL ACTION NO.
§ A 94 CA 081-JN
TEXAS EQUAL ACCESS §
TO JUSTICE FOUNDATION, §
ET AL., §

ANSWER OF DEFENDANTS TEXAS EQUAL
ACCESS TO JUSTICE FOUNDATION AND W.
FRANK NEWTON, IN HIS OFFICIAL CAPACITY AS
CHAIRMAN OF THE TEXAS EQUAL ACCESS TO
JUSTICE FOUNDATION

(Filed Nov. 3, 1994)

Defendant Texas Equal Access to Justice Foundation and Defendant W. Frank Newton, in his official capacity as Chairman of the Texas Equal Access to Justice Foundation (hereinafter collectively referred to as "Defendants") deny any liability to Plaintiffs and answer their Complaint for Injunctive Relief as follows:

FIRST DEFENSE

Plaintiffs' Complaint for Injunctive Relief fails to state a claim upon which relief can be granted.

SECOND DEFENSE

1. In response to paragraph 1, Defendants admit that Plaintiffs purport to bring this lawsuit challenging

the Texas Interest on Lawyer's Trust Accounts ("IOLTA") program in Texas but deny that Plaintiffs are entitled to any of the relief requested in this lawsuit.

2. Defendants deny the allegations in paragraph 2.

3. In response to paragraph 3, Defendants admit that Plaintiffs purport to object to the Texas IOLTA program but deny that Plaintiffs have stated any causes of action under the First or Fifth Amendments to the U.S. Constitution and deny that Plaintiffs are entitled to the relief Plaintiffs request in this lawsuit.

4. Defendants admit the allegations in paragraph 4, except Defendants deny that Plaintiffs' claims have any merit.

5. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 5.

6. Defendants admit that Plaintiff Michael J. Mazzone is an attorney licensed to practice law in Texas and that he purports to bring this suit on behalf of himself and on behalf of his clients. Defendants are without knowledge or information sufficient to form a belief as to the truth of the remainder of the allegations in paragraph 6.

7. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 7.

8. Defendants admit the allegations of paragraph 8.

9. Defendants admit the allegations of paragraph 9.

10. Defendants admit the allegations in paragraph 10.
11. Defendants admit the allegations in paragraph 11.
12. Defendants admit the allegations in paragraph 12.
13. Defendants admit the allegations in paragraph 13.
14. Defendants admit the allegations in paragraph 14.
15. Defendants admit the allegations in paragraph 15.
16. Defendants admit the allegations in paragraph 16.
17. Defendants admit the allegations in paragraph 17.
18. Defendants admit the allegations in paragraph 18.
19. Defendants admit the allegations in paragraph 19.
20. Defendants admit the allegations in paragraph 20.
21. Defendants admit the allegations in paragraph 21.
22. Defendants admit the allegations in paragraph 22.
23. Defendants admit the allegations in paragraph 23.
24. Defendants admit the allegations in paragraph 24.
25. Defendants admit the allegations in paragraph 25.
26. In response to paragraph 26, Defendants admit that there are state-law procedures for amending rules governing the State Bar of Texas, including, in some instances, a referendum. Defendants deny that a referendum was required to amend Article XI and the rules governing the operation of the Texas IOLTA Program.
27. Defendants admit the allegations in paragraph 27.

28. Defendants admit the allegations in the first sentence of paragraph 28, but deny that interest income generated by the Texas IOLTA program totals \$10 million per year in recent years.

29. In response to paragraph 29, Defendants admit that the Texas IOLTA program provides funds to eligible organizations to provide legal services to eligible individuals. Defendants deny that IOLTA funds are used to support redistricting litigation. Defendants deny that plaintiffs' purported objections to the Texas IOLTA program state claims for relief under the First or Fifth Amendments to the U. S. Constitution. Defendants are without knowledge or information sufficient to form a belief as to the truth of the remainder of the allegations in paragraph 29.

30. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 30.

31. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in the first sentence of paragraph 31. Defendants admit that Plaintiff Mazzone, as an attorney, owes his clients certain fiduciary duties that are defined by the Texas Rules of Disciplinary Procedure, Texas statutory law and Texas common law. Defendants deny the remainder of the allegations in paragraph 31.

32. Defendants deny the allegations in paragraph 32.

33. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 33.

34. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 34.

35. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 35.

36. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 36.

37. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 37.

38. Defendants deny the allegations in the first sentence of paragraph 38. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in the second sentence of paragraph 38.

39. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 39.

40. Defendants admit the allegations in paragraph 40.

41. Defendants admit that the State Bar Rules authorize the Texas Equal Access to Justice Foundation to notify the State Bar of Texas of the names of Texas attorneys who are not in full compliance with IOLTA program requirements, and that lawyers who fail to comply with

such IOLTA requirements despite being notified by the State Bar of Texas of their obligation to comply may be subject to immediate suspension. Defendants deny the remainder of the allegations in paragraph 41.

42. Defendants reallege and incorporate by reference their responses to paragraphs 1-41 in response to paragraph 42.

43. Defendants deny the allegations in paragraph 43.

44. Defendants deny the allegations in paragraph 44.

45. Defendants reallege and incorporate by reference their responses to paragraphs 1-44 in response to paragraph 45.

46. Defendants admit that the Fifth Amendment to the U.S. Constitution provides that private property shall not be taken for public use without just compensation. Defendants deny the remainder of the allegations in paragraph 46.

47. Defendants deny the allegations in paragraph 47.

48. Defendants reallege and incorporate by reference their responses to paragraphs 1-47 in response to paragraph 48.

49. Defendants deny the allegations in paragraph 49.

50. Defendants deny that Plaintiffs are entitled to any of the relief prayed for by Plaintiffs.

51. Any allegation in Plaintiffs' Complaint for Injunctive Relief not expressly admitted above is denied.

THIRD DEFENSE

Plaintiffs' claims for relief are barred by the Doctrine of Sovereign Immunity.

FOURTH DEFENSE

Plaintiffs' claims for relief are barred by the Eleventh Amendment.

Defendants reserve the right to amend their Original Answer based upon additional investigation and discovery of the claims made against them in this action.

WHEREFORE Defendants Texas Equal Access to Justice Foundation and W. Frank Newton in his capacity as Chairman of the Texas Equal Access to Justice Foundation demand that all relief sought by Plaintiffs be denied, that the Complaint for Injunctive Relief be dismissed with prejudice, that Defendants recover their court costs and attorney's fees in defending this action and for such other and further relief to which they may be entitled at law or in equity.

Respectfully submitted,

HUGHES & LUCE, L.L.P.
111 Congress Avenue, Suite 900
Austin, Texas 78701
(512) 482-6800
(512) 482-6859 (FAX)

By: /s/ Brittan L. Buchanan
Darrell E. Jordan
State Bar No. 00000064

H. Robert Powell
State Bar No. 16197000

Brittan L. Buchanan
State Bar No. 03285680

**ATTORNEYS FOR THE TEXAS
EQUAL ACCESS TO JUSTICE
FOUNDATION DEFENDANTS**

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of November, 1994, a true copy of the foregoing Answer was mailed, certified mail, return receipt requested, to the following:

Mr. Daniel J. Popeo

Ms. Nancy Trease

Mr. Richard A. Samp
WASHINGTON LEGAL
FOUNDATION

Mr. Harry Potter
OFFICE OF THE
ATTORNEY GENERAL

2009 Massachusetts
Ave., NW
Washington, DC 20036

P.O. Box 12548
Austin, Texas 78711

Mr. Steven W. Smith
3608 Grooms Street
Austin, Texas 78705

Mr. Michael J. Mazzone
Nine Greenway Plaza,
Suite 2300
Houston, Texas 77046

/s/ Brittan L. Buchanan
Brittan L. Buchanan

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL	§	
FOUNDATION <i>et al.</i> ,	§	
Plaintiffs,	§	CIVIL ACTION
v.	§	NO. CA 94-081
TEXAS EQUAL ACCESS TO	§	JN
JUSTICE	§	
FOUNDATION <i>et al.</i> ,	§	
Defendants.	§	

ANSWER OF SUPREME COURT DEFENDANTS

The Supreme Court defendants THOMAS R. PHILLIPS, RAUL A. GONZALEZ, JACK HIGHTOWER, NATHAN L. HECHT, LLOYD DOGETT, JOHN CORNYN, BOB GAMMAGE, CRAIG T. ENOCH, and ROSE SPECTOR, Justices of the Supreme Court of Texas, answer the plaintiffs' complaint as follows:

1. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 1 of the complaint.
2. Defendants deny the allegations of paragraph 2.
3. Defendants are without sufficient knowledge to admit or deny the alleged objections of plaintiffs. Defendants deny that there has been any taking of IOLTA trust accounts in violation of the First or Fifth Amendments to the U.S. Constitution and deny that plaintiffs are entitled to the relief requested in this lawsuit.
4. Defendants admit the allegations of paragraph 4.

5. Defendants are without sufficient knowledge to admit or deny the allegations in paragraph 5.

6. Defendants admit that Plaintiff Michael J. Mazzone is an attorney licensed to practice law in Texas. Defendants are without knowledge or information sufficient to form a belief as to the truth of the remainder of the allegations in paragraph 6.

7. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 7.

8. Defendants admit the allegations of paragraph 8.

9. Defendants admit the allegations of paragraph 9.

10. Defendants admit the allegations of paragraph 10.

11. Defendants admit the allegations of paragraph 11.

12. Defendants admit the allegations of paragraph 12.

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14. Defendants admit the allegations of paragraph 14.

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16. Defendants admit the allegations of paragraph 16.

17. Defendants admit the allegations of paragraph 17.

18. Defendants admit the allegations of paragraph 18.

19. Defendants admit the allegations of paragraph 19.

20. Defendants admit the allegations of paragraph 20.

21. Defendants admit the allegations of paragraph 21.

22. Defendants admit the allegations of paragraph 22.

23. Defendants admit the allegations of paragraph 23.

24. Defendants admit the allegations of paragraph 24.

26. In response to paragraph 26, Defendants admit that there are state-law procedures for amending rules governing the State Bar of Texas, including, in some instances, a referendum. Defendants deny that a referendum was required to amend Article XI and the rules governing the operation of the IOLTA program.

27. Defendants admit the allegations of paragraph 27.

28. Defendants admit the allegations in the first sentence of paragraph 28, but deny that interest income generated by the Texas IOLTA Program totals \$10 million per year in recent years.

29. In response to paragraph 29, Defendants admit that the Texas IOLTA Program provides funds to certain organizations that meet the criteria of the Texas IOLTA Program and the such funds are used to provide legal services to low-income clients of such recipient organizations. Defendants deny that plaintiffs' objections to the Texas IOLTA Program state claims for relief under the First of Fifth Amendments to the U.S. Constitution. Defendants also deny that IOLTA funds are authorized for use in support of redistricting litigation or any other class action litigation. Defendants are without sufficient knowledge to admit or deny the remainder of the allegations in paragraph 29.

30. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 30.

31. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 31. Defendants admit that Plaintiff Mazzone owes his clients certain fiduciary duties that are defined by the Texas Rules of Disciplinary Procedure, Texas statutory law and Texas common law. Defendants deny the remainder of the allegations in paragraph 31.

32. Defendants deny the allegations of paragraph 32.

33. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 33.

34. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 34.

35. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 35.

36. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 36.

37. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 37.

38. Defendants deny the allegations of the first sentence of paragraph 38. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations of the second sentence of paragraph 38.

39. Defendants are without sufficient knowledge to admit or deny the allegations of paragraph 39.

40. Defendants admit the allegations of paragraph 40.

41. Defendants admit that the State Bar Rules authorize the Texas Equal Access to Justice Foundation to

notify the State Bar of Texas of the names of Texas attorneys who are not in full compliance with IOLTA program requirements, and that lawyers who fail to comply with such IOLTA requirements despite being notified by the State Bar of Texas of their obligation to comply may be subject to immediate suspension. Defendants deny the remainder of the allegations of paragraph 41.

42. Defendants reallege and incorporate by reference their responses to paragraphs 1-41 in response to paragraph 42.

43. Defendants deny the allegations of paragraph 43.

44. Defendants deny the allegations of paragraph 44.

45. Defendants reallege and incorporate by reference their responses to paragraphs 1-44 in response to paragraph 45.

46. Defendants admit that the Fifth Amendment to the U.S. Constitution provides that private property shall not be taken for public use without just compensation. Defendants deny the remainder of the allegations of paragraph 46.

47. Defendants deny the allegations of paragraph 47.

48. Defendants reallege and incorporate by reference their responses to paragraphs 1-47 of response to paragraph 48.

49. Defendants deny the allegations of paragraph 49.

50. Defendants deny that Plaintiffs are entitled to any of the relief prayed for by plaintiffs. To the extent that plaintiffs assert any claim to money damages, defendants assert that such claims are barred by the Eleventh

Amendment to the Constitution of the United States and by the sovereign immunity of the State of Texas.

WHEREFORE the Supreme Court defendants request that all relief sought by Plaintiffs be denied, that the Complaint for Injunctive Relief be dismissed with prejudice and for such other and further relief to which they may be entitled at law or in equity.

Respectfully submitted,

DAN MORALES
Attorney General of Texas

JORGE VEGA
First Assistant Attorney General

TONI HUNTER, Chief
General Litigation Division

/s/ Nancy A. Trease
NANCY A. TREASE
State Bar No. 20205200
Assistant Attorney General
P.O. Box 12548, Capitol
Station
Austin, Texas 78711
Phone No. (512) 463-2120
Fax No. (512) 320-0667

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document has been sent via U.S. Mail, on November 3, 1994 to:

Michael J. Mazzone
2927 Georgetown
Houston, Texas 77005

Daniel J. Popeo
Richard A. Samp
Washington Legal
Foundation
2009 Massachusetts
Avenue, N.W.
Washington, D.C. 20036

Darrell E. Jordan
H. Robert Powell
Brittan L. Buchanan
Hughes & Luce, L.L.P.
111 Congress Avenue,
Suite 900
Austin, Texas 78701
Stephen W. Smith
3608 Grooms Street
Austin, Texas 78705

/s/ Nancy A. Trease
NANCY A. TREASE
Assistant Attorney General

**THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION**

WASHINGTON LEGAL §
FOUNDATION, ET AL., §

Plaintiffs, §

v. §

TEXAS EQUAL ACCESS TO §
JUSTICE FOUNDATION, §
ET AL., §

Defendants. §

CIVIL ACTION NO.
A 94 CA 081-JN

AFFIDAVIT OF BRUCE T. BUELL**PERSONAL BACKGROUND**

1. My name is Bruce T. Buell. My business address is Suite 1000, 90 South Cascade Avenue, Colorado Springs, CO 80903. My telephone number is (719) 475-7730. I am over 21 years of age, am of sound mind, and am fully competent to testify in this matter. I have personal knowledge of the facts contained herein and they are true and correct.

PROFESSIONAL BACKGROUND

2. I am admitted to the practice of law in the State of Colorado and am a partner in the law firm of Holland & Hart. I received a Bachelor's Degree from Princeton University in 1953 and my LL.B. from the University of Denver College of law in 1958. I also attended Harvard Law School and George Washington University Law School. I was admitted to the Colorado Bar in 1958. I

joined Holland & Hart as an associate in 1958 and was admitted to the firm as a partner in 1964. I have been a partner with the firm continuously since that time. I practiced in our Denver office from 1958 through 1986 and in our Colorado Springs office from 1986 to the present.

BANKING LAW EXPERIENCE

3. I worked in three different banks prior to commencing the practice of law. After joining Holland & Hart, I immediately began representing the Colorado Bankers Association, a principal client of the firm. In 1962, I became the lead attorney for the Colorado Bankers Association and was designated its general and legislative counsel. I served in that capacity until 1985. I have represented numerous banks throughout my legal career and for a period of five years was general counsel and a director of a bank in the Denver area. I have also represented the Federal Deposit Insurance Corporation and the Resolution Trust Company. I have been involved in the development of banking legislation and regulations both on the state and federal levels. I have written numerous articles on banking law subjects, have prepared a number of manuals for guidance of bankers and have addressed numerous banking seminars and groups. I am listed under the Banking Law specialty in "The Best Lawyers in America".

IOLTA EXPERIENCE

4. I was the Chair of the Colorado Bar Association Committee which developed the Colorado IOLTA program starting in 1982. The Colorado program is called the Colorado Lawyer Trust Account Foundation ("COLTAF"). I drafted the application to the Federal Reserve Board and personally worked with the General Counsel of the Federal Reserve Board in order to obtain approval of IOLTA bank accounts for the Colorado program. I was principal draftsman of the Colorado Supreme Court Rule (DR 9-102) which authorized a voluntary IOLTA program. COLTAF commenced operations in 1983 as the fourth IOLTA program in the nation. I served as the first President of COLTAF. In 1988, I led the effort to convert COLTAF from a voluntary to a mandatory program and this was approved by the Colorado Supreme Court in February 1989. I was principal draftsman of the Rule approved by the Supreme Court. When Colorado adopted the Rules of Professional Conduct to replace the Code of Professional Responsibility in 1992, I acted as principal draftsman of Rule 1.15 concerning client trust accounts which was approved by the Supreme Court. I retired from the Board of Directors of COLTAF in 1992. On the national level, I was a member of the National Advisory Committee for IOLTA commencing in 1982 and became a member of the American Bar Association Commission on IOLTA soon after it was established in the late 1980's. I was Chair of the Banking Committee of the Commission. I also served as liaison between the ABA Commission on IOLTA and the American Bankers Association during my term on the commission. I retired from the Commission in 1992. I frequently have been asked to

consult on banking issues by various state IOLTA programs.

SUMMARY OF OPINIONS

5. I have reviewed the pertinent Texas Rules of Professional Conduct (Rule 1.14), the State Bar of Texas Rules (Article XI) and the Rules Governing the Operation of the Texas Equal Access to Justice Program (collectively the "Rules").

6. Consistent with similar rules in other states, the Rules direct attorneys to deposit client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time ("eligible funds") in a separate interest-bearing "IOLTA" account at a financial institution. Such funds may be deposited in an unsegregated account. The interest on such an account is payable to the Texas Equal Access to Justice Foundation ("the Foundation").

7. The premise of the Rules is that these eligible funds cannot reasonably earn income to benefit individual clients for whom the funds are held (Art XI, Sec. 2(A)). The attorney is permitted to consider overhead costs in maintaining an account on which interest would accrue to the client in determining whether or not client deposits are eligible funds (Operational Rules, Rule 6). The Rules in these respects are consistent with ethical rules nationwide.

8. The Rules also require that the lawyers promptly deliver to the client any funds that the client is entitled to receive (Rule 1.14(b)). Accordingly, the Rules do not

deprive the client of any rightful possessory interest the client may have in his funds.

9. Traditionally, the only depository account which satisfied the three requirements of (i) federal deposit insurance, (ii) immediate availability of funds and (iii) bearing interest, has been the Negotiable Order of Withdrawal ("NOW") account. Financial institutions are authorized to establish and maintain NOW accounts under 12 U.S.C. § 1832 ("the Statute").

10. Under Section (a)(2) of the Statute, NOW accounts may consist " . . . solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for . . . charitable purposes." This section has been interpreted by the banking regulatory agencies to permit the Foundation and organizations similar to it in other states to benefit from the interest earned on client trust accounts on the grounds that the "beneficial interest" referred to in the statute is that of the person or organization entitled to the interest earned on the account.

11. The Statute has also been interpreted:

- a) To permit an individual attorney, but not a partnership or corporate law firm, to establish a NOW account for its own business purposes; and
- b) To permit any lawyer or law firm to establish a NOW trust account where the entire beneficial interest is in one or more individuals or charities.

12. While it is theoretically possible to establish a pooled client trust account with the interest paid to the clients as a NOW account, it would be contrary to the Statute if:

- a) Any client whose funds were on deposit were other than an individual or a charity; or
- b) The law firm deducted any of the interest earned on the trust account to cover its overhead in maintaining the account, calculating and disbursing interest to which the individual clients were entitled or covering the costs of preparing annual IRS form 1099's to report each individual client's interest. If the law firm were to invade the earned interest for these costs, the "entire beneficial interest" would not vest with the client.

These restrictions have generally inhibited lawyers, law firms and financial institutions from establishing NOW accounts for client trust funds other than as IOLTA accounts.

13. In a similar vein, it is theoretically possible to establish a pooled client trust account as a NOW account solely for individual clients (not partnerships or corporations) as noted in 11(a) above, and contract with the financial institution to perform the accounting and IRS reporting procedures for each individual client instead of the law firm performing these functions. This is sometimes referred to in the literature as "subaccounting." The cost of financial institution subaccounting would technically be deducted as a service charge or fee by the depository against earned interest. Subaccounting has not proven economical as the costs have exceeded the small amounts of interest earned on each individual's nominal or short term funds. Thus, no net interest is paid to the clients.

14. Nowhere in the Rules do I find any prohibition against a lawyer establishing a client trust account either

on a pooled or individual client basis, with the interest payable to the client, where the lawyer reasonably expects the account to earn net interest for the client. Operational Rule 6 ("eligible funds") is particularly helpful and constructive in guiding the lawyer to make the proper decision in each case. Rule 6 instructs the lawyer that:

- a) The lawyer must consider the interest earned on the funds of each particular client, that is, he cannot set off the overhead costs relating to one client against the interest earned on funds of other clients (Rule 6 does not relate to whether the account is a separate individual account or a pooled account); and,
- b) The lawyer must consider the likely "overhead costs" inherent in bank service charges and accounting. If he believes the service charges will be minimal or nil, and if he is prepared to do the accounting and tax reporting without charge, nothing in the Rules precludes the lawyer from establishing an account with interest paid to the individual client even with so-called "nominal or short term funds," so long as it can be legally done under the Statute (see paragraphs 10-12 above).

Further Affiant sayeth not.

/s/ Bruce Buell
Bruce T. Buell

STATE OF COLORADO)
) ss.
 COUNTY OF EL PASO)

Subscribed and sworn to before me this 29th day of
 November, 1994, by Bruce T. Buell.

My Commission expires: May 2, 1995.

[SEAL]

/s/ Judith M. Schaefer
 Notary Public

THE UNITED STATES DISTRICT COURT
 FOR THE WESTERN DISTRICT OF TEXAS
 AUSTIN DIVISION

WASHINGTON LEGAL §
 FOUNDATION, §
 ET AL., §

Plaintiffs, §

v. §

TEXAS EQUAL ACCESS TO §
 JUSTICE FOUNDATION, §
 ET AL., §

Defendants. §

CIVIL ACTION No.
 A 94 CA 081-JN

AFFIDAVIT OF EUGENE COOK

STATE OF TEXAS §
 §
 COUNTY OF BEXAR §

BEFORE ME, the undersigned authority, on this day
 personally appeared EUGENE COOK, who, after being
 duly sworn, stated as follows:

1. "My name is Eugene Cook. I am over twenty-one
 years of age, of sound mind, and in all things legally
 competent to testify in this matter. I have personal knowl-
 edge of the facts contained herein and they are in all
 things true and correct.

2. A biographical summary of my background and
 experience is attached hereto as Appendix 1.

3. I was a Justice of the Supreme Court of Texas in 1988 when the Court was evaluating whether to convert the Texas Equal Access to Justice Program (the "Texas IOLTA Program") from a voluntary program to a mandatory program. Based on the Court's opinion that a mandatory IOLTA Program would further the state's interest in providing equal access to justice, on December 13, 1988 the Court entered an Order converting the Texas IOLTA Program into a mandatory program.

4. The State Bar of Texas is an integrated bar. That is to say, an attorney that wants to practice law in this state must become a member of the State Bar. The source of the Bar's authority to regulate the practice of law in Texas is derived both from the Texas Legislature and the Supreme Court of Texas. The Supreme Court of Texas is charged with setting the standards for admission to the practice of the law in this state, as well as promulgating the standards of professional conduct Texas lawyers must follow in their law practice. By imposing ethical and professional standards on its member lawyers, the State Bar is fulfilling the state's interest of regulating the practice of law to assure that attorneys are not only professionally competent to render legal services, but that such services are rendered in an ethical and responsible manner. Accordingly, attorneys not only have ethical obligations to their clients, but owe ethical duties to the Judiciary, to fellow lawyers and to the public as a whole. It is important that lawyers conduct their profession in such a manner that inspires respect and confidence from the public. Such respect is most assured when the public perceives attorneys not only as persons engaged in their profession for pecuniary gain, but also as professionals charged with

the spirit of public service directed toward serving the interests of justice.

5. The public and the interests of justice are served when attorneys do their part in assuring that all persons have access to the legal system. In criminal cases, such access is facilitated by the state and federal court appointment system. In civil matters such access has traditionally been provided by lawyers through their acceptance of cases, *pro bono*.

6. In 1990, the Supreme Court of Texas adopted a version of the Model Rules of Professional Responsibility ("Disciplinary Rules"). The current rule regarding the safekeeping of client property, Disciplinary Rule 1.14, also requires that attorney's deposit client funds in trust accounts and that such funds be delivered on demand.

7. The Texas IOLTA Program represents an extension of attorneys' ethical responsibility to maintain client trust accounts.

8. While some Texas attorneys, including those party plaintiff in this case, may object to the IOLTA Program, it must be remembered that the practice of law is a privilege not a right. Because attorneys are entrusted with the operation of the legal system, the practice of law is regulated by the states through their respective bars to assure that attorneys render legal services in a competent and ethical manner. Accordingly, basic standards of professional competence govern the admission to practice law, and ethical rules govern the means which attorneys may employ in representing their clients. Lawyers are also obligated by the Bar and the Judiciary to render

certain services to the public, including accepting criminal appointments and *Pro Bono* cases. While attorney's may object to donating their services, such objections cannot constitute claims for relief because the attorneys have assumed such responsibilities upon deciding to practice to law in this state. As with any other ethical obligation, attorneys have assumed the responsibility of complying with IOLTA as well.

9. The Texas IOLTA Program does not implicate attorneys' property or associational rights. Attorneys have never had any property right to client funds nor the interest earned on such funds. Likewise, lawyers are not "associated" with the clients they are appointed to represent, or the clients they retain. Lawyers are only associated with the right to legal representation, not their client or the client's objective. Any perceived "association" by an attorney while representing a client does not have First Amendment implications. If there is any association, it is justified as part and parcel of the social responsibility lawyers assume when they become members of this regulated profession.

10. Clients do not have any greater associational rights in the attorney/client relationship than their lawyers do. Clients have a right to counsel of their choice, but they must chose [sic] counsel that is regulated by their respective State Bar. Clients accept the legal representation provided by their lawyers along with all of the ethical obligations imposed on such lawyers. To hold otherwise would impair the state's ability to regulate the practice of law. For example, several of the Texas Disciplinary Rules go the core of an attorney/client relationship such as the attorney/client privilege. Texas

Disciplinary Rule 1.05 recognizes a lawyers duty to maintain the confidential information relayed by clients, but also expressly recognizes that lawyers must disclose such confidential information when the lawyer has reason to believe it is necessary to do so in order to prevent the client from committing a criminal or fraudulent act. Likewise, Texas Disciplinary Rule 1.02 prevents attorneys from assisting clients in engaging in criminal or fraudulent conduct. Texas Disciplinary Rule 3.03 prevents lawyers from knowingly allowing their clients to offer false evidence or testimony. Texas Disciplinary Rule 4.01 requires lawyers to disclose confidential information when it is required to avoid making the lawyer a party to a criminal or fraudulent act. Each of these rules impairs a lawyers ability to act in the unrestricted direction of a client. Clients cannot object to their attorney's obligation to comply with the forgoing rules because clients are only entitled to obtain legal representation to employ means or accomplish goals that are within the parameter the state has set for its legal system. The Texas IOLTA Program is no different than any other ethical rule in that regard.

Further Affiant sayeth not.

/s/ Eugene A. Cook
Eugene Cook

STATE OF TEXAS)
) SS.
 COUNTY OF HARRIS)

Subscribed and sworn to before me this 2nd day of
 December, 1994, by Eugene Cook.

My Commission expires:

/s/ Cheryl C. Palazzo
 Notary Public

[SEAL]

CHERYL C. PALAZZO
 Notary Public, State of Texas
 My Commission Expires 7-27-96

IN THE UNITED STATE [sic] DISTRICT COURT
 FOR THE WESTERN DISTRICT OF TEXAS
 AUSTIN DIVISION

WASHINGTON LEGAL)
 FOUNDATION, MICHAEL J.)
 MAZZONE, and WILLIAM R.)
 SUMMARY [sic],)

Plaintiffs,)

v.)

TEXAS EQUAL ACCESS TO)
 JUSTICE FOUNDATION, W.)
 FRANK NEWTON, THOMAS R.)
 PHILLIPS, RAUL A.)
 GONZALEZ, JACK)
 HIGHTOWER, NATHAN L.)
 HECHT, LLOYD DOGETT,)
 JOHN CORNYN, BOB)
 GAMMAGE, CRAIG T. ENOCH,)
 and ROSE SPECTOR,)

Defendants.)

CIVIL NO.
 A-94-CA-081 JN

**AFFIDAVIT
 OF
ARTHUR J. ENGLAND, JR.**

BEFORE ME, the undersigned authority personally
 appeared Arthur J. England, Jr., who says:

1. My name is Arthur J. England, Jr. I am over 21
 years of age and am competent to give this affidavit.
2. I have been asked by Hughes & Luce, L.L.P.,
 counsel for Texas Equal Access to Justice Foundation in
 this proceeding, to express my opinion as to whether the

IOLTA program being challenged in this proceeding fulfills a compelling state interest. I have attached to this letter a biographical summary of my background and experience.

3. I have had significant experience with the formulation and operation of programs which provide interest on lawyers' trust accounts ("IOLTA programs"). As a Justice of the Supreme Court of Florida, I authored the decision of that Court which approved the first IOLTA program in the United States. (Appendix 2). I later authored the Court's opinion which made the Florida IOLTA program operational. (Appendix 3). My role with Florida's IOLTA program led to my involvement with other states that were exploring the concept. I served as chairman of the National IOLTA Clearinghouse, an informational body for jurisdictions interested in considering an IOLTA program, and as a member and chair of its successor organization, the American Bar Association's IOLTA Commission. I also served as an informal resource to numerous state high courts, legislative committees, bars and bar foundations throughout the country (including Texas, for which I was featured in a video presentation), and I formally appeared before several state high courts and the Conference of Chief Justices in connection with IOLTA.

4. A great deal has been written about the legal rights which IOLTA programs do or do not create, and what effect they have had on client funds which are deposited with attorneys. IOLTA programs are best understood, I believe, not through an explanation of how they were created or how they operate, but rather by

comparison with the world of lawyers' trust accounts before the first IOLTA program was adopted.

5. In every state prior to the adoption of an IOLTA program, including Texas before April 30, 1984, lawyers routinely accepted for deposit and safekeeping client funds which were to be used for a variety of purposes connected with their clients' affairs. Among the usual types of deposits made by clients with their attorneys were those designed to be expended on behalf of the clients, such as court costs, filing fees and real estate purchase deposits, and those which represented fee retainers for legal services which had not yet been performed and advance deposits for law firm expenditures which had not been incurred. Under universal rules governing attorneys from their respective state regulatory authorities, and under federal banking laws, all of these funds had three common characteristics.

a. First, the deposits received from clients were aggregated into so-called "trust accounts" held by attorneys in their law firms' names, rather than being deposited on a client-by-client basis. These trust accounts, which comprised commingled client funds, were independent of and maintained separately from the operating accounts by which attorneys conducted the affairs of their law firms.

b. Second, attorney trust accounts were held in non-interest bearing accounts with banking institutions.

c. Third, attorneys were prohibited from benefitting in any way from the trust accounts comprising their clients deposits.

Exemplary of the rules which governed attorneys throughout the country prior to the advent of IOLTA programs was the Texas trust account rule which existed prior to April 30, 1984. (Appendix 4).

6. Prior to the advent of IOLTA programs, no clients earned income on the funds which had been deposited with their attorneys, obviously, as the funds were held in *non-interest bearing* accounts and generated no tangible income whatsoever. Although earnings free to the depositing clients, the interest-free funds held in attorney trust accounts nonetheless constituted productive capital. Those aggregated accounts served to benefit the banks in which the accounts were established by allowing those financial institutions to invest the funds and retain for themselves the earnings thus generated. Notably, the earnings generated on those aggregated trust accounts were not subject to any direction or control by either the attorneys who maintained the accounts, or by the clients of those attorneys from whom the deposits came. Indeed, to the best of my knowledge, no client ever asserted a claim against the earnings of a bank which were produced on the free funds held in aggregated trust accounts established by attorneys, either on the ground of a First Amendment right not to associate with the causes which the bank might support, or as a Fifth Amendment right to be paid the sums earned by those financial institutions under a "fruit of the tree" theory such as was described by the United States Supreme Court in *Himely v. Rose*, 9 U.S. (5 Cranch) 313 (1809).

7. During this pre-IOLTA era, banks were free to use the interest generated on client funds held by their attorneys in those financial institutions for any purpose

whatsoever, including contributions to the charitable objects of the financial institutions' choice, expenditures for lobbying on behalf of financial institutions in state legislatures and Congress, and simply distributions to the owners or shareholders of the financial institutions. During this period, clients had no control over their attorney's choice of the banking institution into which these funds would be deposited (except to the extent that attorneys represented financial institutions which insisted that all accounts of the law firm be maintained with those client institutions).

8. Most significantly, in pre-IOLTA days no client obtained any income on their deposits with attorneys, unless the amounts on deposit were held for such a significant period of time or were large enough to generate income, *and* if the attorney (and/or client) determined that the deposited funds would in fact be invested for the client independent of the attorney's commingled trust account. Clients deposits incapable of generating income by reason of their size or length of retention were routinely placed by attorneys in their unproductive, commingled, non-interest bearing trust accounts.

9. During the pre-IOLTA era, either a state legislature or a state high court, depending on the constitution of each state, maintained control over the manner by which attorneys used clients' funds and maintained them. Exemplary of the type of control maintained over attorneys' trust accounts was the rule adopted by the Florida Supreme Court for the establishment, maintenance and operation of attorneys' trust accounts. (Appendix 5).

10. With the adoption of Florida's IOLTA program in 1978, attention was focused on the legal, ethical, tax and constitutional aspects of attorneys' maintenance of client funds in commingled trust accounts.

a. The legal requirements *had* changed when the United States Congress authorized the creation of NOW accounts, and subsequently gave banking institutions the freedom to allow the payment of interest on all checking accounts.

b. The ethical obligations of attorneys with respect to client funds *did not* change, although the subject was addressed over the next several years through the agencies responsible for governing the ethics of lawyers in each state – either the high court or legislative body of the respective states. Advice for these respective governing authorities was provided by the American Bar Association. See Opinion 348 of the ABA Standing Committee on Ethics and Professional Responsibility (July 23, 1982).

c. Nor did the tax ramifications of client trust funds held by attorneys change, although the subject of IOLTA programs was specifically addressed by the Internal Revenue Service. See Rev. Rul. 81-209.

d. The constitutional aspects of IOLTA programs drew the most concern, and generated extensive decisional analysis by the courts. *But the fundamental nature of client trust funds held in IOLTA programs was unchanged from the pre-IOLTA era, in terms of the constitutional doctrines of the property and associational rights of clients. Constitutional issues were considered at length*

in a series of state and federal appellate decisions, including several state high court decisions which adopted IOLTA programs. The widespread view, on exhaustive analysis, was that there was no constitutional infirmity in IOLTA programs.¹

11. The common ground among the decisions which either approved IOLTA programs or found no constitutional defects, although not always mentioned as such, was the reality that nothing really changed with the advent of IOLTA programs as respects lawyer commingled trust accounts, *except* two constitutionally irrelevant things.

a. First, the earnings on client deposits were generated overtly for the first time, rather than being generated invisibly on the profit and loss statements of banking institutions. This was relevant in practical, albeit non-constitutional terms, because the federal tax laws do not treat as "taxable income" the imputed earnings on free funds held by banks. This phenomenon of congressional choice has been recognized by the courts, which observed in terms significant only for federal income tax purposes that IOLTA "created income" where none previously existed.

b. Second, those earnings went for beneficial purposes related to the administration of justice, rather than for the private purposes which were determined exclusively by the banking institutions.

¹ Several of these decisions are attached as composite Appendix 6.

12. The notion of newly-created income where none previously existed provided the answer to the various constitutional challenges which opponents of IOLTA programs had raised. In an economic sense, of course, *nothing* had changed from pre-IOLTA money management in the terms of the rights or interests of clients vis-a-vis the funds they deposited with their attorneys. IOLTA programs only created the opportunity for certain groups of clients, and their attorneys, to raise previously unthought-of assertions as to "rights" in the newly-visible proceeds of commingled attorney trust accounts – groups who opposed the delivery of legal services to the poor (the dominant use of IOLTA program funds) as a matter of principle. That is, the very success of IOLTA programs in providing funds for the delivery of legal services to the poor allowed opponents of such programs to argue in constitutional terminology that the funding of the delivery of such services did not fulfill a compelling state interest.

13. I have been asked whether such a state interest *is* met when state courts or legislatures determine that the poor should be given access to courts and attorneys through IOLTA programs. I have no hesitation in saying that these programs *do* fulfill compelling state interests. I pause to restate, however, that I do not consider it even relevant to ask whether there exists a compelling state interest, because there exists in clients no property right of any nature in the earnings on their deposits with attorneys. Individual client deposits so small in amount or so briefly held that earnings could not be generated on

them before 1978 had the same constitutional characteristics, when aggregated in attorney trust accounts providing massed capital to banks, as individual client deposits have now that the earnings on massed capital are disgorged by the banks for the improvement of the administration of justice.

14. The several states in this country establish their policies and compelling state interests through each branch of their governments. The legislative branch, of course, declares public policy and compelling state interests through the enactment of laws. The executive branch does so by executive order or decree, such as would be the case in a declaration of a state of emergency following a natural disaster. The judicial branch, likewise, establishes public policy and compelling state interests through court decisions and orders which affect the administration of justice.

15. Examples of court-created, compelling state interests are the creation of a public defender system following the United States Supreme Court's adoption of the *Gideon* decision (where courts rather than legislatures did so), the maintenance of disciplinary powers over attorneys for breaches of professional duties (including removal from the profession), and the maintenance of the very operations of the court systems through the appointment of attorneys upon a showing of indigency.

16. The dual foundations for IOLTA programs are the public service component of the legal profession imposed by the judicial branch in connection with the admission and discipline of attorneys, and the requirement that there be legal representation for all persons

who utilize the state courts. (See, for example, Appendix 7). These are indeed compelling state interests. IOLTA programs evidence a legitimate regulation of the legal profession, aimed solely at improving the delivery of legal services to the people of this country by enhancing their access to the legal system. IOLTA programs, such as the one in operation in Texas, accomplish the goal of equal access without affecting the attorney/client relationship with respect to the maintenance of client funds, and without taking from clients anything they previously could or did possess.

In my opinion, objections to the Texas IOLTA program on the basis of client-perceived property and associational rights do not rise to any constitutional proportion.

/s/ Arthur J. England, Jr.
Arthur J. England, Jr.

STATE OF FLORIDA)
) SS:
COUNTY OF DADE)

Sworn to and subscribed before me on November 22, 1994. **Arthur J. England, Jr.** personally appeared before me, is personally known to me, and did not take an oath.

Notary: /s/ Clara Torres
Print Name: CLARA TORRES
Notary Public, State of Florida
My commission expires: April 10, 1997

[SEAL]
OFFICIAL NOTARY SEAL
CLARA TORRES
NOTARY PUBLIC STATE OF FLORIDA
COMMISSION NO. CC267803
MY COMMISSION EXP. APR. 10, 1997

THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL	§	
FOUNDATION, ET AL.,	§	
	§	CIVIL ACTION NO.
Plaintiffs,	§	A 94 CA 081-JN
	§	
v.	§	
	§	
TEXAS EQUAL ACCESS TO	§	
JUSTICE FOUNDATION,	§	
ET AL.,	§	
	§	
Defendants.	§	

AFFIDAVIT OF W. FRANK NEWTON

STATE OF TEXAS §
 §
COUNTY OF TRAVIS §

BEFORE ME, the undersigned authority, on this day personally appeared W. FRANK NEWTON, who, after being duly sworn, stated as follows:

1. "My name is W. Frank Newton. I am over twenty-one years of age, of sound mind, and in all things legally competent to testify in this matter. I have personal knowledge of the facts contained herein and they are in all things true and correct.
2. A biographical summary of my background and experience is attached hereto as Exhibit A.
3. I am Chairman of the Texas Equal Access to Justice Foundation (the "Foundation"). The Foundation is

responsible for operating the Texas Equal Access to Justice Program (the "Texas IOLTA Program") pursuant to Art. XI of the State Bar Rules and the Rules Governing the Operation of the Texas Equal Access to Justice Program (the "IOLTA Rules").

4. In the late 1970's, state bars across the country awoke to the idea that the interplay between an attorney's ethical obligations with respect to the management of client funds and federal banking regulations could allow state bars to do more to provide equal access to legal services in civil matters. If the bar established a non-profit organization, lawyers could deposit certain client funds in accounts where the interest earned on such accounts would be designated to be paid to such non-profit organization. In turn, the bar's non-profit organization could distribute the accumulated funds to non-profit legal services organizations whose primary purpose is the delivery of legal services to the poor. This concept is commonly referred to as an Interest On Lawyer Trust Accounts Program ("IOLTA").

5. The IOLTA concept is a unique process that allows the accumulation of client funds to create a benefit previously enjoyed only by the financial institution retaining the deposits. IOLTA functions because of the unique relationship between attorneys and clients with respect to the management of nominal funds or funds held by the attorney for a short period of time. Under the Texas IOLTA Rules, a lawyer who is presented short-term or nominal funds by a client is required to make an initial determination of whether such funds can be deposited into an account that is capable of returning net interest to that client. If such an account is available, the lawyer is

free to deposit the client's funds into such an account. If such an account is not available, the IOLTA Rules merely requires a lawyer to deposit the funds into a reasonably available pooled IOLTA fund.

6. The manner in which Texas lawyers maintain client funds had long been governed by the Texas Code of Professional Responsibility. Former Disciplinary Rule 9-102 required that all client funds paid to a lawyer or law firm be maintained in a bank account. Such funds must be continually accounted for by the lawyer, and must be promptly returned to the client as requested. Former Disciplinary Rule 9-102 also prohibited lawyers from commingling clients funds with their own. Accordingly, Texas lawyers were prohibited from pooling client funds in an interest bearing trust account in order to benefit from that interest. The current rule regarding the safekeeping of client property, Disciplinary Rule 1.14, also requires that attorneys deposit client funds in trust accounts and that such funds be delivered on demand. Due to the ethical obligation that a lawyer remit client funds on demand, attorneys could not deposit funds in interest bearing accounts to benefit their clients because historically banks only paid interest on deposits for term. With the advent of negotiable order on withdrawal ("NOW") accounts, attorneys had the option of depositing client funds in a NOW account when such funds were sufficient to generate interest that would net a return to the client. Due to the limitations the Federal Banking Regulations imposed on the entities entitled to maintain NOW accounts, however, there remained many instances where client funds could not be deposited in an

interest bearing checking account. Despite the new availability of NOW accounts, in order to comply with their ethical obligations lawyers continued to deposit significant sums of money in non-interest bearing accounts. Of course, the "non-interest bearing" aspect of such accounts only applied to the depositors. Banks had long benefited from the accumulation of depositors funds in their reserve accounts where they earned interest that profited the bank. In other words, the Texas IOLTA Program merely diverts the formerly unseen accumulation of interest from the depository banks to the Foundation. In so doing, funds can now be accumulated for distribution to other non-profit organizations whose sole purpose is to provide legal services to the poor. Accordingly, the Texas IOLTA Program is a legitimate regulation of the legal profession aimed at improving the quality of the legal service available to *all* the people of Texas.

7. The Texas IOLTA Program was first created by order of the Supreme Court of Texas in 1984. In so doing, Texas joined a growing number of states that implemented an IOLTA Program to address the continuing unmet need for legal services experienced by the poor. The original Texas IOLTA Program was voluntary. After the voluntary program had been in operation for several years, it became apparent that the funds raised through a voluntary program were insufficient to make a significant impact on the legal needs of the state's poor. The Supreme Court of Texas ordered a study to be conducted by an IOLTA study commission to evaluate the voluntary IOLTA program and determine whether the program was meeting the legal service needs of the state's poor and whether a mandatory program would further meet those

needs. I was a member of that IOLTA study commission. The IOLTA study commission concluded that the legal service needs of the poor were not being fully met under the voluntary program and issued a report recommending to the Supreme Court of Texas that the Texas IOLTA Program be converted into a mandatory program. A true and correct copy of the Report of the IOLTA Study Commission is attached hereto as Exhibit B. At the same time, the American Bar Association ("ABA") was encouraging state bars across the nation to convert their voluntary IOLTA programs into mandatory ones. Based on the IOLTA study commission's report and encouragement by the ABA, the Supreme Court of Texas entered an Order on December 13, 1988 converting the Texas IOLTA Program into a mandatory program. Under the voluntary program the Foundation only distributed approximately \$2,318,000 in grants. The success of the mandatory program has been astounding. Since 1992, the Foundation's annual reports indicate that it has distributed at least \$18,000,000 in grants.

8. By Order of the Supreme Court of Texas, the Foundation has state-wide authority to act, and carries out the Court's recognized obligation to provide access to the legal system for all Texans on a state-wide basis. Without the power granted to it by the Court, the Foundation would have no power to act, as it serves entirely at the pleasure of the Court. Accordingly, the Foundation functions as an arm or agency of the Court. The Foundation is also analogous to a division of the State Bar of Texas, as the bar promulgated rules regarding compliance with the Foundation's mandates.

9. The conversion of the Texas IOLTA Program from a voluntary program to a mandatory one had no effect on an attorney's ability to place client funds into a non-IOLTA account if the funds would generate net interest to the client. Lawyers have always owed their clients a certain responsibility with respect to the management of client funds. These responsibilities include a prohibition on commingling an attorney's funds with the funds of his clients, and the requirement that client funds must be maintained in trust accounts. The mandatory nature of the Texas IOLTA Program merely requires lawyers to place funds incapable of generating net interest to individual clients into IOLTA accounts rather than accounts where the depository banks would retain the interest. In this regard, the Texas IOLTA Texas Program is essentially an extension of the Rules of Professional Conduct with respect to client funds. Operation of the Texas IOLTA Program is not expressive nor is it intended to have any communitive quality at all. IOLTA's only goal is to provide a process that enables persons to obtain legal services who, because of their economic condition, would not otherwise have access to such services. All grants are awarded in a content-neutral manner. Recipients are targeted on an economic basis, focusing on the needs within a geographic region and a potential recipient organization's fiscal responsibility. The Grant Application published by the Foundation reflects the content-neutral manner of the grant process. A true and correct copy of the Grants Package distributed by the Foundation in the Spring of 1994 is attached hereto as Exhibit C. Eighty-five percent of available Foundation funds are awarded to meet the unmet needs for legal services experienced in

those counties in which the greatest number of impoverished individuals reside. The remaining fifteen percent of available Foundation funds are awarded to meet special unmet needs that are not geographic in nature.

10. IOLTA funds are not awarded to promote any particular ideology or political agenda. In fact, no consideration is given to the political or ideological character that might be attributed to a recipient organization. The IOLTA Rules expressly prohibit grant recipients from using funds for reasons other than providing individuals access to the legal system. Moreover, IOLTA funds cannot be used to fund class-action lawsuits, lawsuits against governmental entities, or political lobbying. Finally, the recipient organizations generally do not acknowledge in any public way that they are supported by IOLTA monies. It is virtually impossible for anyone to be associated with the subject matters of the litigation brought by the persons who are the beneficiaries of the recipient organizations. The Foundation has never considered it necessary to put a disclaimer in its materials that IOLTA, as a funding source, does not necessarily support or advocate any of the positions advocated by any litigant who receives legal services as a result of funding provided through IOLTA.

11. Such disclaimers have not been published because, until the present suit was filed, no one foresaw that such an association would be a cause of concern to anyone. For example, the perceived association of which Plaintiffs complain is so attenuated that truly no possibility exists that Plaintiffs could be identified with the views of those asserting the legal claims of which they object. Plaintiffs tender funds to attorneys who, in turn,

deposit those funds into a bank account that may earn interest eventually paid to the Foundation, which in turn distributes the monies to qualified recipient organizations who, in turn, hire personnel to provide legal services to qualified impoverished persons, some of whom may have a legal problem which will require a lawyer to advocate a position on behalf of the qualified individual to which Plaintiffs may object.

12. In any event, the Texas IOLTA Program is only enforceable against lawyers. Neither clients nor banks are required to comply. In that regard, it should not be forgotten that client's also have the freedom of choosing their lawyers. For example, one lawyer might require a retainer of nominal or short-term funds while another attorney may not. And, even if an attorney requests a short-term or nominal retainer, the client is free to negotiate an alternative financial arrangement with the attorney if he desires. Of course, the IOLTA Rules do not prohibit lawyers from structuring their agreement regarding the management of client funds in such a way that nominal or short-term deposits are never held in trust by the lawyer. Lawyers are not required to fund IOLTA with their own money or with bar dues, but are merely required to account for client funds that are nominal or short-term in amount in a different fashion. Of course, the principal amount of the funds tendered by the client in trust is *never* affected by the Texas IOLTA Program. Principal funds are maintained in a trust account just as if there were no IOLTA Program. All the Texas IOLTA Program does is direct that the interests earned on those funds be delivered to the Foundation rather than remain with the depository bank.

13. As evidenced by the forgoing discussion, the Texas IOLTA Program serves a significant and compelling state interest and is narrowly tailored to serve that interest without infringing constitutional rights. It is indisputable that our government has a significant and compelling interest in providing its citizens full access to the legal system. It is equally clear that government has a significant and compelling interest in regulating the legal profession to ensure that such access is facilitated by the ethical and competent provision of legal services by attorneys. IOLTA is an expression of both these state interests. There remains a substantial number of poor in need of legal services in this state. Although such need should be beyond question, in 1990-1992 the State Bar of Texas conducted a Needs Assessment Survey to evaluate where such needs were the greatest. A true and correct copy of the Needs Assessment Survey conducted by the State Bar of Texas is attached hereto as Exhibit D. The State's interest in providing equal access to the legal system would be achieved less effectively if the current Texas IOLTA Program did not exist. If the Texas IOLTA Program did not exist, literally tens of thousands of Texans would be without access to the legal system.

Further Affiant sayeth not.

/s/ W. Frank Newton
W. Frank Newton

STATE OF TEXAS)
) SS.
COUNTY OF TRAVIS)

Subscribed and sworn to before me this 2nd day of December, 1994, by W. Frank Newton.

My Commission expires:

/s/ Cheryl Taylor
Notary Public

[SEAL]

Cheryl Taylor
Notary Public, State of Texas
My Comm. Expires 01/04/97

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL)	
FOUNDATION, <i>et al.</i>)	
)	
Plaintiffs,)	
)	Civ. Action No.
v.)	A94 CA 081-JN
)	
TEXAS EQUAL ACCESS TO)	
JUSTICE FOUNDATION, <i>et al.</i> ,)	
)	
Defendants.)	
)	

AFFIDAVIT OF MICHAEL J. MAZZONE
IN SUPPORT OF PLAINTIFFS'
MOTION FOR SUMMARY JUDGMENT

MICHAEL J. MAZZONE states as follows:

1. I am a citizen of Houston, Texas. I make this affidavit in support of Plaintiffs' motion for summary judgment. I have personal knowledge of the matters stated herein.

2. I am an attorney licensed to practice law in Texas and am a shareholder in the law firm of Dow, Cogburn & Friedman, P.C. (the "Law Firm") in Houston, Texas.

3. In accordance with Article XI of the State Bar Rules and the Rules Governing the Operation of the Texas Equal Access to Justice Foundation (the "Rules"), the Law Firm maintains an IOLTA account into which I regularly place client trust funds that either are nominal in amount or are reasonably anticipated to be held for a short period of time.

4. I have determined from experience that as a practical matter I cannot operate my law practice without collecting client funds that are either nominal in amount or are reasonably anticipated to be held for a short period of time. I have also determined that funds falling within those categories cannot practicably be placed into separate interest-bearing accounts, because the additional costs of establishing and maintaining such accounts usually would exceed any interest I could earn for my clients.

5. Accordingly, as I have interpreted Article XI and the Rules, I have no choice but to place funds described in Paragraph 4 into the Law Firm's IOLTA account. I have had my clients' funds on deposit in that account at all times for the past several years.

6. I have reviewed the Texas Equal Access to Justice Foundation's (TEAJF) most recent annual reports, in particular those pages in the reports (attached) that list the names of organizations to which TEAFJ [sic] provides funds and the litigation activity for which those funds are earmarked. I oppose the objectives of some of the listed litigation activity and therefore object to being forced to associate with such activities by being required to deposit client trust funds into the Law Firm's IOLTA account. I also object, as trustee for my clients, to TEAJF's expropriation of the interest generated by the use of my clients' funds; if such interest is to be generated, it ought to be paid to my clients. I also object to being prevented from fully carrying out my fiduciary responsibilities to my clients by not being permitted to afford my clients the option of designating that their trust funds not be placed into the Law Firm's IOLTA account.

7. I am a member of the Washington Legal Foundation (WLF) and have asked WLF to assist me in protecting my constitutional rights and those of my clients, which I believe are being infringed by the TEAJF activities described above.

I declare under penalty of perjury that the foregoing is true and correct. Executed on this 1st day of December, 1994.

/s/ Michael J. Mazzone
MICHAEL J. MAZZONE

SWORN TO AND SUBSCRIBED BEFORE ME on this the 1st day of December, 1994.

[SEAL]
MARY G. GRUSH
Notary Public,
State of Texas
My Commission Expires
4-7-95

/s/ Mary G. Grush
NOTARY PUBLIC,
STATE OF TEXAS
My Commission
Expires: 4-7-95

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL)	
FOUNDATION, <i>et al.</i>)	
Plaintiffs,)	
)	Civ. Action No.
v.)	A94 CA 081-JN
TEXAS EQUAL ACCESS TO)	
JUSTICE FOUNDATION, <i>et al.</i> ,)	
Defendants.)	
_____)	

AFFIDAVIT OF WILLIAM R. SUMMERS
IN SUPPORT OF PLAINTIFFS'
MOTION FOR SUMMARY JUDGMENT

WILLIAM R. SUMMERS states as follows:

1. I am a citizen of Missouri City, Texas. I make this affidavit in support of Plaintiffs' motion for summary judgment. I have personal knowledge of the matters stated herein.

2. I am a businessman. My work requires me to make regular use of the services of attorneys.

3. The attorneys whom I have retained have on occasion - as a condition of their agreement to represent me - required that I pay them a retainer fee. The attorneys have not applied the retainer against future legal services; rather, I have been billed separately for those services. The retainer has been held in trust for me by the attorneys, with the understanding that it would be returned to me at the conclusion of the matter giving rise

to the legal representation. It was my understanding that the attorneys would draw against the retainer if I failed to pay my legal bills in a timely manner.

4. In December 1992, I was named as a defendant in civil litigation which arose in connection with one of my business ventures. Pursuant to the agreement under which I hired an attorney to represent me, I paid the attorney a small retainer fee as outlined in Paragraph 3 above – my attorney holds the full amount of the retainer and bills me for services rendered on a periodic basis. The litigation is on-going, and the attorney continues to hold the retainer.

5. In January 1994, my attorney informed me for the first time that he had deposited the retainer into his law firm's IOLTA account and that all interest earned on that account is paid to the Texas Equal Access to Justice Foundation (TEAJF) in order to support Texas's IOLTA program.

6. I subsequently informed my attorney that I did not want my funds used to support the Texas IOLTA program and thus objected to his placement of my retainer into his law firm's IOLTA account. He responded that he was required by state law to keep the funds in that account because under state law his only other option was to set up a separate account for my funds – an unfeasible option because the cost of establishing and administering a separate account for my funds most likely would exceed any interest that could be earned on those funds.

7. If interest is to be generated through the use of my funds, I object to those funds going to anyone other than me.

8. I have reviewed TEAJF's most recent annual reports, in particular those pages in the reports (attached) that list the names of organizations to which TEAJF provides funds and the litigation activity for which those funds are earmarked. I oppose the objectives of some of the listed litigation activity and therefore object to the use of my funds to support those activities.

9. I am a member of the Washington Legal Foundation (WLF) and have asked WLF to assist me in protecting my constitutional rights, which I believe are being infringed by the TEAJF activities described above.

I declare under penalty of perjury that the foregoing is true and correct. Executed on this 1st day of December, 1994.

/s/ William R. Summers
WILLIAM R. SUMMERS

SWORN TO AND SUBSCRIBED BEFORE ME on this the 1st day of December, 1994.

/s/ Sheila Litchfield
NOTARY PUBLIC,
STATE OF TEXAS

My Commission Expires:_____

[SEAL] SHEILA LITCHFIELD
NOTARY PUBLIC,
STATE OF TEXAS
MY COMMISSION EXPIRES
FEB. 14, 1998

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL)	
FOUNDATION, MICHAEL)	
J. MAZZONE, and)	
WILLIAM R. SUMMARY [sic],)	
Plaintiffs,)	CIVIL NO.
)	A-94-CA-081 JN
v.)	
TEXAS EQUAL ACCESS TO)	
JUSTICE FOUNDATION, W.)	
FRANK NEWTON, THOMAS R.)	
PHILLIPS, RAUL A. GONZALEZ,)	
JACK HIGHTOWER, NATHAN)	
L. HECHT, LLOYD DOGGETT,)	
JOHN CORNYN, BOB)	
GAMMAGE, CRAIG T. ENOCH,)	
and ROSE SPECTOR,)	
Defendants.)	

AFFIDAVIT

OF

CHARLES E. ROUNDS, JR.

BEFORE ME, the undersigned authority personally appeared Charles E. Rounds, Jr., who says:

1. My name is Charles E. Rounds, Jr. I am over 21 years of age and am competent to give this affidavit.

2. I was counsel to the exclusive managers of a two hundred year trust established under the will of Benjamin

Franklin (the "Franklin Trust"). The Franklin Trust terminated June 30, 1991. I am currently counsel to The Franklin Foundation as it is trustee of trusts established by the Commonwealth of Massachusetts and the City of Boston with terminating distributions from the Franklin Trust.

3. I am co-author of the Seventh Edition of *Loring: A Trustee's Handbook* (Little, Brown & Co.-1994). The Handbook will have its one hundredth anniversary in 1998.

4. I am author of *Social Investing, IOLTA, and the Law of Trusts: The Settlor's Case Against the Political Use of Charitable and Client Funds*, 22 Loyola University of Chicago Law Journal 163 (1990).

5. I am a tenured full professor of law at Suffolk University Law School, in Boston, Massachusetts. I have taught trusts at Suffolk since 1978.¹

6. From 1977 to 1983, before accepting a full-time appointment at Suffolk University Law School, I was employed by The First National Bank of Boston, first in its Office of Trust Counsel and then in the General Counsel's Office. In both capacities, I specialized in trust-related matters.

7. I have reviewed the November 22, 1994 affidavit of Arthur J. England, Jr. (the "Affidavit") which was attached to the Defendants' Motion for Summary Judgment in this case. The Affidavit contains a number of

¹ From 1978 to 1983 I taught trusts as a member of the Suffolk University Law School adjunct faculty. During that period I was serving in the Office of Trust Counsel and then in the General Counsel's Office at The First National Bank of Boston (now known as the "Bank of Boston").

factual inaccuracies. Moreover, the Affidavit obfuscates the fundamental legal relationships inherent in the Texas IOLTA scheme.

8. The legal relationships between and among the parties have never been in dispute and are as follows:

- a. The **attorney** is the trustee of IOLTA funds;²
- b. The bank in which IOLTA funds are deposited is in a debtor/creditor (contractual) relationship **with the attorney-trustee**;
- c. The client is a beneficiary of the commingled IOLTA trust and the holder of a general inter vivos power of appointment with respect to that portion of the trust principal allocable to the client;
- d. **THE BANK IS NOT A TRUSTEE OF IOLTA FUNDS**; and
- e. **THE CLIENT IS NOT IN A CONTRACTUAL RELATIONSHIP WITH THE BANK.**

9. In Para. 4 of the Affidavit it is suggested that "IOLTA programs are best understood . . . not through an explanation of how they were created or how they operate, but rather by comparison with the world of lawyers' trust accounts before the first IOLTA program was adopted." Yet, whether the client-beneficiary's equitable

² In Para. 2 a. of the Affidavit, reference is made to "so-called" trust accounts. They *are* trusts. The relationship between the attorney and the client with respect to the funds is not that of principal/agent or debtor-creditor. The qualification "so-called" suggests that the term "trust" is inaccurate in the context of IOLTA. The Affidavit, however, contains no explanation as to why that would be the case.

or beneficial interest in the trust property (its "use") is being taken by the state is solely [sic] dependent upon **how** the scheme **now** operates. It has nothing whatsoever to do with the "world of lawyers' trust accounts" before 1978.

10. In Para 6. of the Affidavit there is the following statement:

"Indeed, to the best of my knowledge, no client ever asserted a claim against the earnings of a bank which were produced on the free funds held in aggregated trust accounts established by attorneys . . ."

This statement presupposes that the bank is the trustee. It is not. The bank is only a debtor of the attorney-trustee. As such, the funds are properly commingled with the general assets of the bank. The Plaintiffs are *not* asserting a claim against the "earnings of a bank." The client-beneficiaries are asserting that when there is a choice as to how **their own entrusted property** is to be used, they have a Fifth Amendment right to make that choice. The type of entrusted property at issue here is the contractual obligation of the bank (i.e. the account).

11. In Para. 10 b. of the Affidavit it is suggested that when the United States Congress authorized the creation of NOW accounts, "[t]he ethical obligations of attorneys with respect to client funds *did not* change." Of course they did. Now the individual client-beneficiary has a practical choice as to how **his own property** could be invested: namely, either in an interest-bearing account or a non-interest-bearing account. The attorney, serving in two separate fiduciary capacities (as trustee of the client's

property and as attorney-at-law) had a double fiduciary duty to act solely [sic] in the interest of his client-beneficiary. He became obliged under the common law, if nothing else, to apprise the client-beneficiary of that choice and to facilitate the making of that choice. The attorney-trustee ought not to be subject to license suspension for carrying out his common law fiduciary obligations.

12. In Para. 10 d. it is suggested that "[c]onstitutional issues were considered at length in a series of state . . . decisions, including several state high [sic] court decisions which adopted IOLTA programs." Yes, the schemes were "considered" but for the most part they were considered by the very same entities that had created them. There has been very little independent judicial analysis of the concept. Moreover, I know of no scholarship – independent of the organized bench and bar establishment – that supports the concept.

13. In Para 11 a. there is the following observation:

"First, the earning on client deposits were generated overtly for the first time, rather than being generated invisibly on the profit and loss statements of banking institutions."

The concept of "overt income generation" and "invisible income generation" has no meaning whatsoever in trust or property law. Moreover, the statement suggests that the bank is the trustee. It is not. It is a debtor, a party to a contract with the attorney-trustee. The issue is not – nor has it ever been – what is going on "on the profit and loss statements of banking institutions." All that has happened with the advent of the NOW account is that the individual client-beneficiary now has a practical choice as to how his attorney-trustee may invest the entrusted

property. Finally, the statement suggests that clients should be penalized for not immediately insisting that their attorneys put their trust funds to productive use. The statement suggests that since the organized bar first thought of how to make client trust money productive, then the organized bar ought to be able to dictate how those trust funds are used. The organized bar appears to be saying: "Because *we* thought of a way to make *your* money productive, *we* get to dictate how *you* use *your* money."

14. In Para. 14 of the Affidavit there is the following sentence:

The judicial branch, likewise, establishes public policy and compelling state interests through court decisions and orders which affect the administration of justice.

While the judicial branch may have a right to regulate attorneys in the practice of law, it has no right to expropriate and appropriate the equitable or beneficial interest (the "use") of the entrusted property of the non-lawyer citizen who employs an attorney, no matter how "compelling the state interest." Moreover, what constitutes a "compelling state interest" is a question of Federal constitutional law; the state court may not immunize its decrees from Federal constitutional challenge simply by declaring that the interest advanced by the decree is "compelling."

15. In Para. 16 of the Affidavit, there is the assertion that "IOLTA programs evidence a legitimate regulation of the legal profession." False. They evidence an illegitimate

interference in the property rights of citizens who happen to avail themselves of the legal system.

16. In my opinion, objections to the Texas IOLTA program on the basis of the property and associational rights of clients are valid. IOLTA violates the 1st and 5th Amendments of the U.S. Constitution. It is crucial that the concept be deprived of its apparent judicial validation.

/s/ Charles E. Rounds, Jr.
Charles E. Rounds, Jr.

COMMONWEALTH OF MASSACHUSETTS

COUNTY OF SUFFOLK

DATE: 12-14-94

Sworn to and subscribed before me.

/s/ Stephen A. Hill
Notary Public
My commission expires:
November 23, 2001

THE UNITED STATE [sic] DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

WASHINGTON LEGAL	:	
FOUNDATION, et al.	:	
	:	
	:	Plaintiffs
	:	Civil Action No.
-against-	:	A94 CA 081-JN
TEXAS EQUAL ACCESS TO	:	
JUSTICE FOUNDATION, et al.	:	
	:	
	:	Defendants

AFFIDAVIT OF ROBERT J. RANDELL

I, **ROBERT J. RANDELL**, an attorney and counsellor at law of the State of New York, do hereby affirm as follows:

2. I make this affidavit at plaintiffs' request to aid the Court in its consideration of the nature and operation of IOLTA trust or escrow accounts. My familiarity with the subject is outlined below. I have read and am familiar with the affidavit of Bruce T. Buell, Esq., submitted to the court by the defendants, and I will address some its content as well.

3. I have been closely involved with escrow regulations for attorneys since 1986. In connection with my general real estate work I had established a method of allocating interest among funds in pooled escrow accounts and for providing monthly escrow statements to

clients, as well as a basis for allocating an attorney's escrow administrative fee. It eventually was used commercially by me under a corporate name as an escrow service for attorneys. This led to my becoming fully acquainted with attorneys' general escrow practices and with IOLTA legislation and its impact on the way escrow funds are handled by attorneys. As a result of this I have authored articles for attorneys on escrow management and IOLTA practices. The corporate escrow service is no longer operating. Its function is largely accomplished nowadays by bank sub-accounting, which has become commonplace in New York and elsewhere.

4. I reside at 30 Amherst Road, in Valley Stream, Long Island, New York, and maintain an office for the practice of law at 880 Third Avenue, Manhattan, New York City, New York. I was admitted to practice in New York in April, 1954. I have been admitted *pro hac vice* in the states of Connecticut and New Jersey in real property litigation. I am also admitted to practice before the Southern, Eastern and Northern United States District Courts of New York and before the Supreme Court of the United States.

5. I am a member of the New York County Lawyers' Association, of New York City, where I served on its Real Property Committee for more than six years. I am also a member of the Nassau County Bar Association (the County in which I reside), where I presently serve on the Professional Ethics Committee and on the Community Relations and Public Education Committee.

6. I am a graduate of Brooklyn Law School, in New York City. I clerked while attending law school in the

office of Nathan L. Goldstein, a condemnation and real estate tax certiorari specialist and former Special Assistant U. S. Attorney General for condemnation in the New York metropolitan area. I stayed with the firm for 7 years after admission before entering private practice, still maintaining a specialty in condemnation and real estate tax certiorari. My practice then branched out into general real estate as well as other areas. I have represented such clients as Korean Airlines (negotiation and execution of long term lease for New York City midtown Manhattan headquarters), and the J.C. Penney Company with respect to its department store at Sunrise Mall, in Massapequa, Long Island (in real estate tax certiorari proceedings for 12 years).

Sub-Accounting of Attorney Trust Accounts

7. I must thoroughly disagree with Mr. Buell's statement in paragraph 13 of his affidavit, based on certain unspecified "literature", with respect to bank sub-accounting. He states that sub-accounting has not proven economical because bank costs exceed the small amounts of interest earned on each individual escrow fund. Apparently this is speculation, since it is couched in hypothetical terms. He says that the cost of sub-accounting "would technically" be deducted as a service charge or fee by the depository, and opines that it is only "theoretically possible" to establish such sub-accounts. Mr. Buell is evidently not familiar with current banking practices and services available for trust account administration.

8. It is common knowledge that today, interest net of any fees can be earned on virtually *all* client funds through bank sub-accounting. In most cases it can be earned for the client without any greater administrative cost than required to maintain an IOLTA account. Except perhaps only for the smallest transient deposits, the amount of interest earned will always exceed any added cost of administering the sub-account, because there is virtually no added cost.

9. In fact, bank sub-accounts are inherently *less* expensive to administer than pooled IOLTA accounts, considering that in both cases an attorney has a fiduciary obligation to keep detailed accounting records of the history of each client's separate fund. With bank sub-accounting all the arithmetic is done by the depository. Running balances with accrued interest are maintained for each client's fund and are shown on monthly statements. Year-end IRS 1099's are provided as well, without charge. The attorney will spend less of his own time in general escrow administration using bank sub-accounts than if he maintains a pooled IOLTA account. With an IOLTA account, it is left to the attorney alone to compute what each client has in the account and to make sure the total of the individual client deposits coincides with the IOLTA total.

10. This can be seen from the escrow sub-account 'kit' entitled "Client Funds Account", obtained by the undersigned from Chemical Bank, one of the larger banks in the country. It is attached as Exhibit "A" to this affidavit. Chemical Bank offers unlimited sub-accounting with no minimum balances for each client's escrow, no minimum balance for the attorney's main account, no

service fees whatever, and telephone transfers from the sub-accounts to the main escrow account when disbursement is required. Accrued interest is ultimately reported to the IRS under the client's tax identification number through the 1099 reporting system employed by the bank for depositors.

11. In contrast to the much larger Chemical Bank, a small community based bank on Long Island, The Bank of Great Neck, which has only one banking office, likewise offers unlimited sub-accounting with no minimum client balances, no monthly fees, telephone transfers, a separate IOLTA account for purely transient deposits, and IRS 1099 reports. Its advertisement for these services is shown in a current issue of "Nassau Lawyer", the official publication of the Nassau County Bar Association, at page 14. The advertisement is attached as Exhibit "B" to this affidavit.

12. In still other instances, bank charges for sub-accounting services, though they exist, are minimal. For example, Citibank, NA offers escrow accounts with monthly statements showing each client's sub-account, and furnishes all of the other services mentioned, for individual client escrows of at least \$500. NatWest Bank (formerly National Westminster Bank, USA) offers unlimited client sub-accounts, showing the same detail, with no minimum client sub-account balances and all of the services mentioned, all for a flat monthly fee of \$10. These are only some examples of interest earning alternatives available to attorneys in the New York City metropolitan area, at no extra cost or at a cost that is bound to be less than the benefit gained for clients.

13. Mr. Buell's statements, therefore, are not only hypothetical and theoretical, but are proven wrong by operation of the market place for bank trust account sub-accounting services.

14. Moreover, it appears that highly sophisticated computer installations are not required for banks to furnish sub-accounting services to attorneys. Sub-accounting systems use the same data-bases already in place for keeping track of bank customers and their accounts. In addition, sub-accounting does not involve the breaking down and allocation of the aggregate interest earned by the total of the escrows listed under the 'umbrella' of the attorney's main trust account. Rather it merely requires that for informational and administrative purposes the separate interest-bearing 'sub-accounts', which are each independently started at the attorney's request using the client's tax identification number, be linked electronically to the attorney's main account. A single composite monthly statement is rendered showing interest credited directly to the individual sub-accounts. The interest is thus identified as belonging solely to the client. However, in keeping with the attorney's role as escrowee and fiduciary, control of the funds remains exclusively in the attorney's hands, and they are disbursed solely through the umbrella account.

The Ethical Basis of IOLTA Trust Accounts

15. The underlying premise of the IOLTA Rule under consideration by the court, described by Mr. Buell in paragraphs 6 and 7 of his affidavit, is that "eligible funds" (in New York these are referred to as "qualified

funds") are those that cannot reasonably earn enough income to benefit the individual clients for whom the funds are held. This is the same premise relied on in ethics opinions rendered throughout the country that IOLTA deposits of such funds by attorneys are proper exercises of fiduciary discretion.

16. In New York, for example, the IOLA ("IOLA" is the acronym used in New York) statute, Judiciary Law 497, refers to such funds when defining deposits that 'qualify' for IOLA accounts. The operative words in the "qualified funds" definition are that such funds would not earn "sufficient interest to justify the expense" of a separate account for the client's benefit [NY Judiciary Law 497, subd.2].

17. The New Jersey IOLTA rule (Rule 1:28A-3(a)(2), New Jersey Rules of General Application) defines the equivalent of "eligible" or "qualified funds" more succinctly. It says they are funds that "would not earn interest in excess of the cost incurred to secure such interest".

18. IOLTA programs first became popular during a period when it was not feasible to allocate interest among escrows in pooled accounts or to establish escrow sub-accounts. Their ethical basis rested on the premise that there is no fiduciary obligation to obtain interest for a client if the cost of doing so exceeds the gain. Thus, the client was said to have no reasonable expectation of obtaining such interest. In some instances this formed a basis for saying the client was never the owner of the interest - even though interest was ultimately realized by the bank depository or by IOLTA by reason of the deposit. Mr. Buell refers to this rationale in paragraph 8

of his affidavit when he states that IOLTA does "not deprive the client of any *rightful* possessory interest the client may have in his funds [emphasis supplied]". The same argument is made in defendants' Memorandum of Authorities, at pages 12-14.

19. In the real world, divorced from such legalisms, experience tells us that it would be startling for a client to learn that he is not the owner of interest which could be earned on the client's money when deposited in an attorney's trust account – no matter what the amount of that interest might be. The client might acknowledge that, as a practical matter, the cost of obtaining the interest would preclude his ever receiving it, but it would be incomprehensible to him why money earned on his own money was not his property.

20. Before bank sub-accounting and office computer systems for allocating interest became cost-effective, whether the client was to be deemed the owner of trust account interest garnered under IOLTA was of no financial significance, since, in the legitimate exercise of the attorney's fiduciary duty, the result was the same. The client did not receive the interest because the attorney was under no ethical or fiduciary duty to obtain it for him. But this assumption underlying IOLTA's operation is no longer valid. It has expired through the passage of time and the progress of technology. Its continued operation as a mandatory program under present day circumstances is inherently confiscatory and oppressive to clients in everyday practice.

The Confiscatory Nature Of Mandatory IOLTA Programs

21. If IOLTA programs had remained voluntary, presumably an attorney who participated could have determined 'eligibility' for IOLTA treatment based on his client's consent. This changed when, in the late 1980's, jurisdiction after jurisdiction imposed mandatory rules governing the exercise of the attorney's discretion and excluded the client from the process altogether.

22. It is no answer to say, as defendants argue in their Memorandum of Authorities, that theoretically an attorney has discretion under the Texas IOLTA rule to make cost-effective interest-bearing trust deposits for the client's benefit. The court will determine whether such discretion is permitted. But even if such discretion exists, this is not the result the rule is designed to achieve, and, more importantly, it is not the way IOLTA operates in practice.

23. It is obvious that mandatory IOLTA regulation of attorneys' fiduciary discretion is designed to enhance IOLTA revenues, not to safeguard client trust account interest. Were this not so, mandatory IOLTA programs would be designed to compel all trust deposits to be made into interest bearing accounts for the *client's* benefit, save only for those deposits that the client consented be made in IOLTA accounts. IOLTA programs operate, without exception, in exactly the opposite way, and without the consent of the client.

24. Whether, in any particular instance, an IOLTA statute or rule is unconstitutionally confiscatory on its face is, of course, a matter for judicial determination. However, there can be no doubt that the restrictions

imposed on attorneys' fiduciary discretion by IOLTA statutes and rules are inherently confiscatory when, for example, in defining "eligible" or "qualified" funds, they require the value of all escrow services performed by the attorney to be used in the cost-effective analysis, or when they prescribe minimum interest guidelines for determining whether a deposit is to be considered "nominal". Application of these formulas has led to abuses that are readily apparent in ordinary practice. I outlined them in an article published in the New York Law Journal on May 16, 1994 (front page), entitled "Avoiding IOLA Abuses", which I append to this affidavit as Exhibit "C" for the court's perusal, rather than repeat its content herein.

25. One of these mechanism [sic] can be seen in paragraph 7 of Mr. Buell's affidavit, where he describes how overhead costs in maintaining an interest bearing account for the client are required to be considered by the attorney when determining whether client deposits are eligible funds. Presumably this includes the costs incurred by the attorney, personally or by staff members, for services which would have to be performed in any event were the escrow deposited in an IOLTA account.

26. Contrary to Mr. Buell's conclusion that the client will lose nothing that is rightfully due him, the IOLTA rule as described by Mr. Buell re-defines the attorney's fiduciary duty and contravenes the ethical basis upon which IOLTA programs are said to rest. The result is inherently confiscatory by restricting an attorney's conduct in acting on behalf of the client's beneficial interest. It also restricts an attorney's professional discretion to spend time and money for the client, without charging

the client, in order to obtain a benefit for the client for whatever reason the attorney chooses.

27. Thus, while giving 'lip-service' to ethical concepts with respect to an attorney's fiduciary duty to the client, IOLTA regulations impose threshold guidelines on attorneys' discretion which almost always insure that significant amounts of interest that could have, and should have been earned for clients will be paid instead to IOLTA. Moreover, despite profound changes in the practical administration of trust funds - changes that necessarily affect the basis of the ethical legitimacy of mandatory IOLTA programs - IOLA and IOLTA advocates continue to insist, as Mr. Buell does in his affidavit, that no untoward appropriation of client interest occurs based on the application of IOLTA guidelines.

28. Nevertheless, for example, the New York IOLA Fund reported that in 1990 and 1991 collections of interest on so-called "nominal" deposits amounted to over \$22 million *in each year*. In 1992 and 1993 the collections dropped to \$14 million and then to \$8 million dollars, respectively, because of lowering interest rates. Based on money market interest rates during those years, the amount of "nominal" funds constantly on deposit in IOLTA (IOLA) accounts in New York can be estimated to have ranged between \$340 and \$466 million.

I declare under penalty of perjury that the foregoing is true and correct.

Executed by me this 16th day of December, 1994.

/s/ Robert J. Randell
Robert J. Randell

SUPREME COURT OF THE UNITED STATES
OFFICE OF THE CLERK
WASHINGTON, D. C. 20543

June 27, 1997

Mr. H. Robert Powell
Hughes & Luce
111 Congress, Suite 900
Austin, TX 78701

Re: Thomas R. Phillips, et al.
v. Washington Legal Foundation, et al.
No. 96-1578

Dear Mr. Powell:

The Court today entered the following order in the above entitled case:

The petition for a writ of certiorari is granted, limited to Question 1 presented by the petition.

Sincerely,

/s/ William K. Suter
William K. Suter, Clerk

ORDER LIST

FRIDAY, JUNE 27, 1997

CERTIORARI GRANTED

96-1578 PHILLIPS, THOMAS, ET AL V. WASHINGTON
LEGAL FDN

The order granting the petition for a writ of certiorari is amended to read as follows:

The petition for a writ of certiorari is granted limited to the following question: Is interest earned on client trust funds held by lawyers in IOLTA accounts a property interest of the client or lawyer, cognizable under the Fifth Amendment of the United States Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could not earn interest for the client or lawyer?

**RULES GOVERNING THE OPERATION
OF THE TEXAS EQUAL ACCESS
TO JUSTICE PROGRAM**

Including Amendments Received Through
February 1, 1997

Research Note

Use WESTLAW® to find cases citing a rule. WESTLAW may also be used to search for specific terms or to update a rule; see the TX-RULES and TX-ORDERS Scope Screens for further information.

Amendments to these rules are published, as received, in South Western Reporter 2d and Texas Cases advance sheets.

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RULE 1. ESTABLISHMENT OF THE TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION

The Texas Equal Access to Justice Program (the "Program"), Article XI of the State Bar Rules adopted and promulgated by the Supreme Court of Texas by Order dated April 30, 1984, shall be administered by the Texas Equal Access to Justice Foundation (the "Foundation"), a Texas Non-Profit Corporation.

RULE 2. ARTICLES OF INCORPORATION AND BYLAWS

The Articles of Incorporation and Bylaws of the Foundation shall be as set forth in Attachments 1 and 2, respectively, hereto.*

RULE 3. DIRECTORS OF THE FOUNDATION

Directors of the Foundation shall be appointed and their terms of office fixed as set forth in Attachment 2. The initial directors of the Foundation are named in Attachment 1.

* Pub. Note: Copies of the Articles of Incorporation and Bylaws of the Texas Equal Access to Justice Foundation are available from the State Bar.

RULE 4. DEPOSIT OF CERTAIN CLIENT FUNDS

An attorney licensed by the Supreme Court of Texas, receiving in the course of the practice of law in this state client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time, must establish and maintain a separate interest-bearing insured depository account at a financial institution and deposit in the account such funds. All client funds may be deposited in a single unsegregated account. Attorneys who practice in a law firm or for a professional corporation may utilize the interest-bearing trust account of such firm or corporation to comply with this Rule 4. The interest earned on the account shall be paid in accordance with and used for the purposes set forth in these Rules. The Foundation shall hold the entire beneficial interest in the interest earned. Funds to be deposited under these Rules shall not include those funds evidenced by a financial institution instrument, such as a draft, until the instrument is fully credited to the financial institution in which the account is maintained. The term "draft" as herein used is defined in Section 3.104(b)(1) of the Texas Business and Commerce Code. A draft or similar instrument need not be treated as a collected item unless it is the type of instrument which the financial institution generally treats as a collected item.

(Amended Dec. 13, 1988, eff. July 1, 1989; May 22, 1991, eff. Jan. 1, 1992.)

RULE 4A. ATTORNEYS WHO DO NOT HANDLE CLIENT TRUST FUNDS

Licensed attorneys who do not handle client trust funds are not required to establish an IOLTA account.

Such attorneys must nevertheless advise the Foundation during the annual IOLTA compliance process that they do not handle client trust funds.

(Adopted May 22, 1991, eff. Jan. 1, 1992.)

RULE 4B. ACCOUNTS UNABLE TO GENERATE NET INTEREST

Licensed attorneys who maintain client trust funds that are nominal in amount or are reasonably anticipated to be held for a short period of time must attempt in good faith to locate an interest bearing account that would generate interest greater than service charges. If such an account cannot be located, the attorney must notify the Foundation during the annual IOLTA compliance process. Such attorney is required to maintain a non-interest bearing client trust account for such funds.

(Adopted May 22, 1991, eff. Jan. 1, 1992.)

RULE 5. ANNUAL NOTICE TO FOUNDATION

Licensed attorneys must advise the Foundation in writing annually as to their IOLTA status as provided in Rule 24.

(Amended Dec. 13, 1988, eff. July 1, 1989; May 22, 1991, eff. Jan. 1, 1992.)

RULE 5A. NOTICE TO FOUNDATION OF CHANGE IN STATUS

Licensed attorneys must notify the Foundation in writing within thirty (30) days of any change in IOLTA status.

(Adopted Dec. 13, 1988, eff. July 1, 1989; amended May 22, 1991, eff. Jan. 1, 1992.)

RULE 5B. NOTICE TO FOUNDATION OF CLOSED ACCOUNT

An attorney, law firm, or professional corporation engaged in the practice of law and maintaining accounts provided for in these Rules must notify the Foundation in writing within thirty (30) days of the closing of such account(s).

(Adopted Dec. 13, 1988, eff. July 1, 1989.)

RULE 5C. NOTICE TO FOUNDATION OF CHANGE IN ELIGIBILITY STATUS [DELETED]

(Deleted May 1, 1991, eff. Jan. 1, 1992.)

RULE 6. FUNDS ELIGIBLE FOR THE PROGRAM

The funds of a particular client are nominal in amount or held for a short period of time, and thus eligible for use in the Program, if such funds, considered without regard to funds of other clients which may be held by the attorney, law firm or professional corporation, could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of

establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client. Also to be considered are the nature of the proceeding or transaction involved and the likelihood of delay in the need for such funds in such proceeding or transaction. The attorney, law firm or professional corporation should exercise good faith judgment in determining initially whether client funds should be included in the Program and should review at reasonable intervals whether changed circumstances require further action with respect to such funds.

RULE 7. ACCOUNTS TO BE MAINTAINED AT FINANCIAL INSTITUTIONS

An account established pursuant to Rule 4 shall be a trust account from which withdrawals or transfers may be made on demand (subject only to any notice period which the financial institution is required to reserve by law or regulation) established in any bank, credit union or savings and loan association, selected in the exercise of ordinary prudence, which is authorized by federal or state law to do business as a banking entity in Texas and insured by the Federal Deposit Insurance Corporation, the National Credit Union Share Insurance Fund, or the Texas Share Guaranty Credit Union or which is a "State Depository" as provided by Article 2529 of the Revised Civil Statutes of Texas.

(Amended May 22, 1991, eff. Jan. 1, 1992.)

RULE 8. INTEREST RATES

An attorney, law firm or professional corporation establishing an account under these Rules shall attempt in good faith to obtain a rate of interest payable on the account not less than the rate paid by the depository institution to other depositors with accounts of similar size. A higher rate offered by the institution on deposits meeting certain time requirements or minimum amounts, such as those offered in the form of certificate of deposit, may be obtained if there is no impairment of the right to withdraw or transfer principal immediately, other than the statutory notification requirements generally applicable to those accounts, even though interest may be lost because of the withdrawal or transfer.

RULE 9. DIRECTIONS TO DEPOSITORIES

The depository institution shall be directed by the attorney, law firm or professional corporation establishing the account:

(a) to remit, at least quarterly, interest earned on the average daily balance in the account, less reasonable service charges, to the Foundation;

(b) to transmit to the Foundation with each remittance a statement showing the name of the attorney, law firm or professional corporation with respect to which the remittance is sent, the rate or rates of interest applied, and the amount of service charges deducted, if any; and

(c) to transmit to the depositing attorney, law firm or professional corporation at the same time a report is sent to the Foundation, a report showing the amount paid

to the Foundation for that period, the rate or rates of interest applied, the amount of service charges deducted, if any, and the average daily account balance for each month of the period for which the report is made.

RULE 10. ORGANIZATIONS ELIGIBLE FOR GRANTS

The Foundation shall make grants to organizations, not individuals. Prior to making its first grant of funds, the Board of Directors of the Foundation shall promulgate a policy, consistent with these Rules, which shall state the criteria to be met by an organization to qualify for a grant. Such criteria shall provide, among other criteria to be specified by the Board of Directors, that the organization must be exempt from taxation under section 501(c)(3) of the United States Internal Revenue Code, as amended, or corresponding provisions of any subsequent United States Internal Revenue law or laws, have as a primary purpose the delivery of legal services to low income persons pursuant to income and type of case criteria acceptable to the Board of Directors, be current in all filings required to be made by it with any governmental authority, maintain open records and conduct open meetings (subject to reasonable limitations for an organization of its type), be an equal employment opportunity employer, and be able to demonstrate that it can utilize any funds granted to it in a manner consistent with these Rules and policies adopted by the Board of Directors of the Foundation. Nothing herein shall be deemed to impair any attorney-client relationship.

RULE 11. PERSONS ELIGIBLE TO BENEFIT FROM GRANTS

Organizations receiving grants of funds from the Foundation shall use such funds to provide legal services to individual indigent persons. Prior to the making of its first grant, and at least annually thereafter, the Board of Directors of the Foundation shall adopt criteria relating to income, assets and liabilities defining the indigent persons eligible to benefit from Foundation grants.

RULE 12. CRITERIA FOR GRANTS

Prior to making its first grant of funds, the Board of Directors of the Foundation shall promulgate a policy, consistent with these Rules, which shall state the criteria to be made for a grant from the Foundation. Such criteria shall provide, among other criteria to be specified by the Board of Directors, that the funds granted by the Foundation may not be used to duplicate a service already funded by another entity or in place of other funds available for the same purpose.

(Amended May 22, 1991, eff. Jan. 1, 1992.)

RULE 13. USE OF FUNDS LIMITED TO CASES WHICH CANNOT GENERATE FEES

Funds granted by the Foundation to organizations to provide legal services to the indigent in civil matters may not be used for any case or matter that, if undertaken on behalf of an indigent person by an attorney in private

practice, might reasonably be expected to result in payment of a fee for legal services from an award to a client, from public funds, or from the opposing party.

RULE 14. EXCEPTION TO RULE 13

The provisions of Rule 13 shall not be applicable in any case where the organization receiving funds granted by the Foundation determines in good faith that the indigent person seeking legal assistance has made reasonable efforts to obtain the services of an attorney in private practice for the particular matter (including contacting attorneys in private practice in the county of residence of the indigent person who normally accept cases of a similar nature), and has been unable to obtain such services because the potential fee is inadequate, is likely to be uncollectible, would substantially consume any recovery by the client, or because of any other reason which the organization, acting in good faith, believes prevents the client from obtaining the services of a private attorney.

RULE 15. FUNDING OF CERTAIN SUITS AND ACTIVITIES NOT PERMITTED

No funds shall be granted by the Foundation to directly fund class action suits, lawsuits against governmental entities, or lobbying for or against any candidate or issue. Provided, however, that funds may be granted to finance suits against governmental entities on behalf of individuals in order to secure entitlement to benefits such as, but not limited to, social security, aid to families with dependent children, food stamps, special education for

the handicapped, Medicare, Medicaid, subsidized or public housing, or other economic, shelter or medical benefits provided directly to indigent individuals.

RULE 16. RECORDS AND REPORTS OF GRANTEES

The Foundation shall require, as a condition to the granting of funds to any organization or program, that adequate provision be made for reports to the Foundation as to the actual use of the funds so granted and for audit of such reports. Each such organization or program receiving funds from the Foundation shall keep its financial records in accordance with generally accepted accounting principles for organizations of its type and shall furnish reports to the Foundation in such form and containing such information as shall be reasonably requested pursuant to policies adopted by the Board of Directors of the Foundation.

RULE 17. CESSATION OF FUNDING

The Foundation may cease funding an organization which fails to act in accordance with the requirements of the Order of the Supreme Court of Texas creating the Program, these Rules or the policies adopted by the Board of Directors of the Foundation as provided in these Rules. The Board of Directors of the Foundation shall adopt appropriate procedures to be followed when it has been determined to cease funding an organization, including reasonable notice to the organization involved, an opportunity to correct any deficiency (if reasonably possible to do so) and a hearing before the Board of Directors.

RULE 18. ADMINISTRATIVE COSTS OF FOUNDATION

The Foundation may expend funds for administrative costs of the Program, including any costs incurred after April 30, 1984, and may provide a reasonable reserve for administrative costs.

RULE 19. RECORDS OF THE FOUNDATION

The records of the Foundation, including applications for funds, whether or not granted, shall be open for public inspection at reasonable times and subject to reasonable restrictions dictated by the operational needs of the Foundation. The Foundation shall maintain its books of account in accordance with generally accepted accounting principles for organizations of its type and shall maintain written minutes of meetings of its Board of Directors and committees. It shall also maintain such other records as are within reasonable policies established by its Board of Directors.

RULE 20. INITIAL DISTRIBUTION OF FUNDS BY THE FOUNDATION

The initial distribution of funds under the Program shall be made at a time when, in the determination of the Board of Directors of the Foundation, there are sufficient funds to provide an adequate distribution.

RULE 21. OTHER INTEREST-BEARING ACCOUNTS

Participating in the Program does not prohibit an attorney, law firm or professional corporation engaged in

the practice of law from establishing one or more interest-bearing accounts or other investments permitted by the Texas Code of Professional Responsibility (Article X, Section 9, State Bar Rules) with the interest or dividends earned on the accounts or investments payable as directed by clients for whom funds are not deposited in accordance with these Rules.

RULE 22. COMPLIANCE WITH CODE OF PROFESSIONAL RESPONSIBILITY

Neither the Foundation nor any organization or program to which it grants funds may take an action or require an attorney to take an action in violation of the Code of Professional Responsibility (Article X, Section 9, State Bar Rules) or in violation of any other code of professional responsibility adopted by this state for attorneys.

RULE 23. ATTORNEY LIABILITY

Nothing in these Rules affects the obligations of attorneys, law firms or professional corporations engaged in the practice of law with respect to client funds other than client funds reasonably determined to be "nominal in amount" or reasonably anticipated to be held for a "short period of time," as those terms are defined by these Rules. An attorney, law firm or professional corporation is not liable in determining which funds are nominal in amount or on deposit for a short period of time if the determination is made in good faith in accordance with these Rules.

RULE 24. COMPLIANCE

(a) On or after June 1 of each year, all attorneys licensed by the Supreme Court of Texas shall report IOLTA compliance in a manner to be prescribed by the Texas Equal Access to Justice Foundation and the State Bar of Texas. Such compliance statements may require such information as is deemed reasonably necessary by the Foundation and the State Bar of Texas and shall be signed by the reporting attorney.

(b) Each attorney must complete an annual compliance statement and return it to the Foundation by the date stated on the compliance statement. If the compliance statement is timely filed, indicating compliance, there will be no acknowledgement. The presumption of compliance after timely filing shall obtain, absent some evidence to the contrary.

(c) Should a compliance statement filed by an attorney fail to evidence compliance, the Foundation shall contact the attorney and attempt to resolve administratively the non-compliance.

(d) The Foundation shall furnish annually to the State Bar of Texas a list of all attorneys licensed by The Supreme Court of Texas (i) who have not timely filed a compliance statement or (ii) as to whom the Foundation has been unable administratively to resolve any impediment to the proper filing of a compliance statement. The State Bar of Texas shall send to each person so reported, by certified mail, return receipt requested, a non-compliance notice. Should the attorney fail or refuse to file the compliance statement within thirty (30) days of such notice, the State Bar of Texas shall so notify the Clerk of

The Supreme Court of Texas, and the attorney shall be immediately suspended as an attorney licensed to practice law in the State of Texas until a compliance statement is filed.

(Adopted Dec. 13, 1988, eff. July 1, 1989; amended May 22, 1991, eff. Jan. 1, 1992.)

RULE 25. REVIEW AND APPEAL

(a) An attorney may file a written request based upon good cause for exemption from compliance with any of the requirements of these Rules, an extension of time for compliance, an extension of time to comply with a deficiency notice, or an extension of time to file an annual compliance statement. Such request shall be reviewed and determined by a Committee established by the State Bar or by such committee as the chairperson may, from time to time, designate. The attorney shall be promptly notified of the decision by the Committee.

(b) "Good cause" shall exist when an attorney is unable to comply with this Article because of extraordinary hardship or extenuating circumstances which were not willful on the part of the attorney and were beyond his or her control.

(c) Should the decision of the Committee be adverse to the attorney, the attorney may request the Board of Directors of the State Bar to review the decision by making such request in writing to the Executive Director of the State Bar within thirty days of notification of the decision of the Committee. The Chairman of the Board may appoint a committee of the Board to review the

decision of the Committee and make a recommendation to the Board. The decision shall be made by the Board.

(d) Should the decision of the Board be adverse to the attorney, the attorney may appeal such decision by filing suit within thirty days of notification of the Board's action, failing which the decision of the Board shall be final. Such suit shall be brought against the State Bar, and shall be filed in a district court in Travis County, Texas. Trial shall be de novo, but the burden of proof shall be on the attorney appealing, the burden shall be by a preponderance of the evidence, and the attorney shall prove the existence of "good cause" as defined herein. The trial court shall proceed to hear and determine the issue without a jury. Either party shall have a right to appeal.

(e) Any suspension of an attorney shall be vacated during the administrative review process and while any suit filed is pending.

(Adopted Dec. 13, 1988, eff. July 1, 1989; amended May 22, 1991, eff. Jan. 1, 1992.)

RULE 26. RETURN TO FORMER STATUS

Any attorney whose license to practice law has been suspended under the terms of these Rules who after the date of suspension files a report with the Foundation showing compliance shall be entitled to have such suspension promptly terminated and be returned to former status. Return to former status shall be retroactive to the inception of suspension, but shall not affect any proceeding for discipline of the member for professional misconduct. The State Bar shall promptly notify the Clerk that

an attorney formerly suspended under these Rules has now complied with these Rules.

(Adopted Dec. 13, 1988, eff. July 1, 1989; amended May 22, 1991, eff. Jan. 1, 1992.)

RULE 27. CONFIDENTIALITY

The files, records, proceedings, as they relate to the compliance or noncompliance of any attorney with the requirements of these Rules, shall be confidential and shall not be disclosed except upon consent of the attorney affected or as directed in the course of judicial proceeding by a court of competent jurisdiction.

(Adopted Dec. 13, 1988, eff. July 1, 1989; amended May 22, 1991, eff. Jan. 1, 1992.)

AUG 25 1997

CLERK

In The
Supreme Court of the United States

October Term, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALÉZ,
 HON. NATHAN L. HECHT, HON. JOHN CORNYN, HON.
 CRAIG T. ENOCH, HON. ROSE SPECTOR, HON.
 PRISCILLA OWEN, HON. JAMES A. BAKER, HON. GREG
 ABBOTT, IN THEIR OFFICIAL CAPACITIES AS
 JUSTICES OF THE TEXAS SUPREME COURT;
 TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION;
 AND W. FRANK NEWTON, IN HIS OFFICIAL
 CAPACITY AS CHAIRMAN OF THE TEXAS EQUAL
 ACCESS TO JUSTICE FOUNDATION,

v.

Petitioners,

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
 SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

On Writ Of Certiorari To The United States Court
 Of Appeals For The Fifth Circuit

BRIEF FOR PETITIONERS

NANCY TREASE
 Office of the Attorney
 General of Texas
 P.O. Box 12548,
 Capitol Station
 Austin, TX 78711
 (512) 475-4075

Attorneys for Petitioners

*Hon. Thomas R. Phillips,
 Hon. Raul A. Gonzalez, Hon.
 Nathan L. Hecht, Hon. John
 Cornyn, Hon. Craig T. Enoch,
 Hon. Rose Spector, Hon. Pris-
 cilla Owen, Hon. James A.
 Baker, Hon. Greg Abbott, In
 Their Official Capacities As
 Justices Of The Texas Supreme
 Court*

DARRELL E. JORDAN*
 BRITTAN L. BUCHANAN
 DAVID J. SCHENCK
 BETH W. BIVANS
 HUGHES & LUCE, L.L.P.
 1717 Main Street, Suite 2800
 Dallas, TX 75201
 (214) 939-5500

Attorneys for Petitioners

*Texas Equal Access to Justice
 Foundation, And W. Frank
 Newton, In His Official
 Capacity As Chairman Of The
 Texas Equal Access To Justice
 Foundation*

August 25, 1997

* Counsel of Record

45 PP

QUESTION PRESENTED

Is interest earned on client trust funds held by lawyers in IOLTA accounts a property interest of the client or lawyer, cognizable under the Fifth Amendment of the United States Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could not earn interest for the client or lawyer?

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BRIEF FOR PETITIONERS

Petitioners, the individual Justices of the Texas Supreme Court, the Texas Equal Access to Justice Foundation, and W. Frank Newton, in his official capacity as Chairman of the Texas Equal Access to Justice Foundation, respectfully request that the portion of the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on September 12, 1996, reversing the District Court below, be reversed.

OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 94 F.3d 996 and is reprinted in the Appendix to the Petition for a Writ of Certiorari. Pet. App. A. The decision of the District Court is reported at 873 F. Supp. 1 and is also reprinted in the Appendix to the Petition for a Writ of Certiorari. Pet. App. B. The order denying Petitioner's request for panel rehearing and the dissenting opinion from the denial of rehearing *en banc* are reported at 106 F.3d 640 and are also reprinted in the Appendix to the Petition for a Writ of Certiorari. Pet. App. C.

JURISDICTION

The judgment of the Fifth Circuit was entered on September 12, 1996. Petitioners timely filed a request for panel rehearing and simultaneously requested rehearing from the Fifth Circuit *en banc*. The petition for panel

rehearing was denied on February 14, 1997. The petition for rehearing *en banc* was denied, with six judges dissenting, on the same day. This Court's certiorari jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1) (1993).

CONSTITUTIONAL AND REGULATORY PROVISIONS INVOLVED

The Fifth Amendment to the United States Constitution and a relevant federal statute are reprinted in the Appendix to the Petition for a Writ of Certiorari. Pet. App. D. Selected orders and regulations promulgated by the Texas Supreme Court are also reprinted in the Appendix to the Petition for a Writ of Certiorari. Pet. App. E-G. The rules governing the operation of the Texas Equal Access to Justice Program are reprinted in the Joint Appendix.

STATEMENT OF THE CASE

Factual Background

Interest on Lawyers' Trust Accounts – IOLTA – programs have been approved in all fifty states and the District of Columbia.¹ The Texas program enables traditionally non-interest bearing client trust fund accounts to

¹ Twenty-seven jurisdictions have mandatory IOLTA programs; twenty-four jurisdictions have optional participation. IOLTA programs have been adopted by court rule in forty-four states and the District of Columbia and by statute in six states. The Indiana Supreme Court has approved in principle the adoption of an IOLTA Program, but the program is not yet operational.

provide interest that finances basic legal services to low-income citizens. The American IOLTA concept originated in Florida, and has since become the backbone of pro bono legal programs throughout the United States.² Nationwide, IOLTA programs currently generate about \$100 million per year. IOLTA programs are second only to federal grants as a source for funding legal services to low-income Americans, helping to provide basic legal services to an estimated 1,700,000 citizens each year. Congressional funds made available through the Legal Services Corporation provide for salaried attorneys who serve the poor full-time. IOLTA programs fund a variety of staff attorney programs, support the part-time pro bono work of private attorneys discharging their ethical obligations, and fund a range of other administrative, educational, and public justice functions.

The Texas IOLTA program began to receive income in 1985, when just under \$47,000 was generated. Even though this initial program depended on voluntary participation by lawyers, it eventually yielded almost \$1 million annually. By Order of the Texas Supreme Court, as of July 1989, every Texas attorney is required to participate in IOLTA, which now produces about \$5 million a year.

To understand why the operation of the Texas IOLTA program and similar programs in other states does not

² *Matter of Interest on Trust Accounts*, 538 So. 2d 448, 449 (Fla. 1989); see also W. Frank Newton & James W. Paulsen, *Constitutional Challenges to IOLTA Revisited*, 101 Dickenson L.Rev. (forthcoming 1997).

violate the Constitution, it is necessary to examine the historic treatment of money received by lawyers from, or on behalf of, their clients, as well as the recent development in federal banking law that made IOLTA programs possible.

Lawyer Trust Accounts Before 1980

For as long as law has been practiced, lawyers and clients have found it desirable, for a variety of reasons, to place client money in the lawyer's possession. The money might be retained as security against future billings, filing fees, or other costs, or the funds might be placed in escrow in anticipation of a real estate closing. For these and many other reasons, an attorney trust account can be convenient for both the attorney and the client. The deposit of client money in an attorney's trust account, however, also offers a unique opportunity for an attorney to abuse a client's trust. As a result, such accounts have historically been the subject of legislative and judicial regulation.

Absent an agreement with the client, rules of professional conduct required that client funds be available on the client's demand and, in all events, prohibited attorneys from benefiting in any way from client's funds. Supreme Court of Texas, State Bar Rules, art. X § 9, Tex. Disciplinary R. of Prof. Conduct 1.14 (Vernon Supp. 1993). Demand deposits were thus aggregated into "trust accounts" held by attorneys in their law firms' names. Because federal banking law did not permit the payment of interest on demand-deposit accounts (*i.e.*, checking accounts), neither lawyers nor their clients received

interest income from the deposit of client funds. Only the financial institution benefited from the deposit.

The 1980 Amendments to Federal Banking Law

In 1980, Congress authorized, with some significant limitations, Negotiable Order of Withdrawal ("NOW") accounts, which for the first time permitted banks to pay interest on demand deposits. 12 U.S.C. § 1832 (1989). Lawyers were thus able to deposit client funds into interest-bearing checking accounts for the benefit of certain clients while simultaneously satisfying the ethical requirement that client trust funds be available upon demand. Indeed, as fiduciaries, lawyers were obligated to deposit these funds into interest-bearing accounts if they were capable of generating interest income in excess of the cost of opening and maintaining the account.

However, even with the advent of NOW accounts, lawyers still received funds incapable of earning interest for the client. For example, NOW accounts are only available to individuals and charitable entities. 12 U.S.C. § 1832(a)(2) (1989).³ Thus, business entities organized as corporations or partnerships cannot receive interest on a demand deposit. More significantly, the funds of non-business clients are often simply too small in amount or are likely to be held for too short a period of time to earn interest in excess of the bank's service charge and the

³ That section permits interest-bearing demand accounts consisting "solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for . . . charitable . . . purposes and which is not operated for profit." 12 U.S.C. § 1832(a)(2) (1989).

lawyer's administrative fee for opening and maintaining a non-IOLTA account. In addition, under the Internal Revenue Code, the income from each subaccount in any pooled account must be reported separately, for which either the bank or the lawyer could properly charge the client a fee.

The Nationwide Adoption of Interest on Lawyer Trust Accounts Programs

In the years following the banking amendments, all fifty states and the District of Columbia adopted ethical rules permitting or requiring attorneys to maintain trust accounts for client funds that are, in the lawyer's judgment, either too small or likely to be held for too short a time to generate interest in excess of the cost required to open and maintain a demand account for the client. These programs generate interest on otherwise unproductive funds and distribute the proceeds to non-profit organizations designated by the legislature or the judiciary to provide legal services to those in need. Funds from depositors ineligible under federal banking laws, such as partnerships or corporations, can lawfully be pooled under 12 U.S.C. § 1832(a)(2) in an IOLTA account, because all of the interest belongs to an eligible non-profit organization. (R. Vol. 3, p. 386). Of greater importance, interest earned on small amounts or funds held for a short time need not be subaccounted by the lawyer or the bank and need not be reported to the IRS. Rev. Rul. 87-2, 1987-1 C.B. 18.

Under the Texas IOLTA rules, when a client entrusts a lawyer with funds, the lawyer must initially determine

whether the funds are capable of returning net interest to that client. In determining the cost of maintaining the account, attorneys consider the cost to the client of opening the account, including his own charge, the bank's fee and the tax reporting cost, the amount of the principal, and the duration of the deposit. *See* IOLTA Rule 6, J.A. at 113-14. If an account is available in which net interest can be earned by the client (or clients, if pooling is permitted by federal banking laws), the lawyer must deposit the client funds into that account. (Newton Affidavit, J.A. 73-74). In many cases, the client's funds are very small, such as a modest retainer, a filing fee, or a refund on expenses; in other cases they are likely to be held for a very short period – a settlement about to be dispersed or a real estate transaction on which only the final title check is to be done. In neither case would there be any net interest income to the client. But IOLTA takes advantage of the charitable exception to the NOW account restrictions by pooling these deposits into a single aggregated account maintained by the lawyer with a nonprofit foundation designated as the beneficiary of that account.

For example, assuming that the total cost to the client for opening an account is \$100, a NOW account paying 2% interest, which is typical of such accounts, would yield net income on a \$100,000 principal deposit after only 19 days. On the other hand, a deposit of \$1,000 under like conditions would require 1,825 days to yield a net return. If client funds are capable of earning net interest in any amount, however, the funds are not eligible for deposit in an IOLTA account. (Newton Affidavit, J.A. 73-74).

IOLTA programs do not require that clients deposit trust funds with their attorneys. That decision, just as it

was before the commencement of IOLTA, is a matter between the individual client and attorney. Moreover, IOLTA itself imposes no interference or restriction upon the client's use of, or access to, the principal amount of the funds deposited in the trust account. The Texas IOLTA Program merely requires lawyers, choosing to accept client funds, to deposit the client funds in an IOLTA account when no account is available that will yield net interest to the client. IOLTA Rule 4, J.A. at 111. Finally, although no bank is required to participate in an IOLTA program, every bank does so voluntarily.

IOLTA programs were not implemented without constitutional scrutiny. Legal issues were raised in every state, and the responses can be found in written administrative orders accompanying the creation of IOLTA programs,⁴ in more traditional adversarial proceedings,⁵ and, in 1987, in a celebrated federal court contest that sought

⁴ E.g., *Petition by Massachusetts Bar Ass'n*, 478 N.E.2d 715 (Mass. 1985) (finding no affected property interest); *Matter of Interest on Lawyers' Trust Accounts*, 675 S.W.2d 355 (Ark. 1984) ("funds in question are not now available to individual clients, and for practical reasons cannot be made available to them"); *Matter of Interest on Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *Petition of New Hampshire Bar Ass'n*, 453 A.2d 1258 (N.H. 1982) (finding no takings impediment); *Matter of Minnesota State Bar Ass'n*, 332 N.W.2d 151, 158 (Minn. 1982) ("no client has a property interest"); *Matter of Interest on Trust Accounts*, 538 So. 2d 448 (Fla. 1989).

⁵ See, e.g., *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962 (1st Cir. 1993); *Carroll v. State Bar of Cal.*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (Cal. Ct. App. 1984).

to derail Florida's program.⁶ In nine adversary or administration decisions IOLTA programs were upheld and constitutional challenges found wanting; in Indiana, the State Supreme Court reversed its earlier position and adopted an IOLTA Program in principle in 1995.⁷ Three relevant administrative decisions were issued by the Texas Supreme Court. Each constitutes an affirmation of the Texas IOLTA program's constitutionality: a 1984 Texas Supreme Court administrative order implementing the state's voluntary IOLTA program,⁸ a 1985 administrative order which specified that the Texas Equal Access to Justice Foundation "shall hold the entire beneficial interest in the interest generated,"⁹ and a 1988 administrative order converting the voluntary program to a mandatory program.¹⁰ Chief Justice Pope, who presided over the Texas Supreme Court in 1984 when the Texas IOLTA program was created, recently said, "[t]here clearly are no constitutional implications. The only funds that qualify for IOLTA accounts are those that never could have

⁶ *Cone v. State Bar of Florida*, 819 F.2d 1002 (11th Cir.), cert. denied, 484 U.S. 917 (1987).

⁷ See, e.g., Brennan J. Torregrossa, Note, *Washington Legal Foundation v. Texas Equal Access to Justice Foundation: Is There an IOTA of Property Interest in IOLTA?*, 42 Vill. L.Rev. 189, 191 n. 8 (1997).

⁸ Texas Supreme Court, Order of May 9, 1984 (available from Texas Supreme Court Clerk's Office).

⁹ Texas Supreme Court, Order of July 1, 1985 (available from Texas Supreme Court Clerk's Office).

¹⁰ Texas Supreme Court, Order of December 13, 1988 (available from Texas Supreme Court Clerk's Office).

earned interest for the client anyway. Nothing is taken."¹¹ Conversion of the voluntary program to a mandatory program in 1988 was prompted by a request from the State Bar of Texas, accompanied by a brief which discussed the question of whether any property right under Texas law was taken.¹² Like every other program to be challenged, the Texas program was upheld.

Proceedings Below

Notwithstanding the extensive review of the constitutional questions surrounding IOLTA in Texas and elsewhere, the Washington Legal Foundation brought suit against the Justices of the Texas Supreme Court, a Foundation created by Order of that Court to provide legal assistance to the poor, and the individual administering that Foundation challenging the Texas IOLTA Program. The suit was filed under 42 U.S.C. § 1983 (1994) on February 7, 1994, in the United States District Court for the Western District of Texas. Subject matter jurisdiction was based on the presence of a federal question under 28 U.S.C. §§ 1331 & 1343 (1994).

Plaintiff-Respondent Washington Legal Foundation is a self-professed conservative "public-interest law firm" that claims to have members in Texas who are opposed to the Texas IOLTA Program. Plaintiff-Respondent Mazzone is an attorney admitted to practice in Texas; Plaintiff-Respondent Summers is a client of Respondent Mazzone.

¹¹ Newton & Paulsen, *supra* note 2 at 24.

¹² *Id.* at 25.

All advance a Fifth Amendment claim to "just compensation" focused on the interest proceeds allegedly "taken" by the Texas IOLTA Program and a First Amendment claim stemming from their objections to how the funds generated by IOLTA are spent. The Fifth Amendment claim to just compensation, applied through the Fourteenth Amendment, is a restatement of the most consistent and seriously treated constitutional complaint about IOLTA. To this often litigated, but never successful, constitutional claim a new wrinkle is added: Plaintiffs borrowed from the law of real property, arguing that one of the core "sticks" in the "bundle of property rights" is the right to exclude others from benefiting from your money. According to this theory, even if clients could not expect to profit from IOLTA interest, they still had a "beneficial interest" in that property, including the right to exclude others from its use. Further, this new interest was also characterized as implicating First Amendment rights, as Plaintiffs objected to the money, which they could not have received themselves, being used to support legal services to the poor.

The District Court refused to dismiss under Federal Rule of Civil Procedure 12(b), considered cross-motions for summary judgment, reviewed summary judgment evidence and concluded that none of the Respondents could identify any property interest or expectation belonging to them that had been appropriated. Respondent Summers offered no proof that any of his funds deposited in an IOLTA account were capable of earning even a cent of interest for his benefit. By stark contrast, Petitioners offered undisputed proof that the Texas

IOLTA program was established as part of the disciplinary rules governing the conduct of Texas lawyers (Cook Affidavit, J.A. at 55-60), that only funds legally or economically incapable of earning interest to benefit clients were eligible for deposit in IOLTA accounts (Newton Affidavit, J.A. at 73-74 and 77), and that lawyers or clients have never had a reasonable expectation to receive interest earned on nominal or short-term funds (England Affidavit, J.A. at 64-67; Newton Affidavit, J.A. at 74-77).

On appeal, the Fifth Circuit reversed. The panel did not mention the Washington Legal Foundation's novel claims – that there was some “beneficial interest” or “right to exclude” accruing to clients or that First Amendment rights of commercial expression were somehow infringed. Instead, the panel explicitly broke with the First and Eleventh Circuits, as well as opinions from several state courts, in order to hold that this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), compelled a finding that clients had an ownership interest in the interest generated by client trust funds – an argument so doubtful that Washington Legal Foundation did not even raise it in its earlier First Circuit challenge.

Petitioners sought a rehearing *en banc*, which was denied over a vigorous dissent. The dissenters pointed out that there was a critically important difference between gross interest and net interest. In this case, the facts showed that gross interest could be earned on IOLTA accounts, but no net interest could be received by individual clients. Thus, according to the dissenters, the absence of any property interest of the Respondents prevented triggering Fifth Amendment just compensation claims.

Both sides sought certiorari. This Court refused to grant certiorari to review whether this case raised issues of state's rights or to review claims, raised by Respondents' Cross-Petition, that this case should be used to review sovereign immunity under the Eleventh Amendment. Rather, certiorari was granted to review the question whether IOLTA programs interfered with property rights in ways that violated either the First or the Fifth Amendments. Thereafter, an additional Order was entered by this Court that limited review to whether IOLTA programs interfered with property rights under the Fifth Amendment.

SUMMARY OF ARGUMENT

The Texas IOLTA Program requires attorneys holding certain client funds in trust to deposit them into an aggregated account if the funds are either too small or likely to be held for too short a time to generate interest in excess of the expense of opening and maintaining the account. The revenue generated by the IOLTA program is used to fund legal services for the State's poor.

The Texas IOLTA Program does not take “property” from anyone. None of the Respondents has lost any interest income or suffered any financial or other loss as a result of the program they challenge. In essence, Respondents object to the fact that interest (which they could not have earned themselves) is being used to provide legal services to the poor. But since they have no right to that interest, Respondents have no legal basis to object to how the money is being used. The response to claims made by

the attorney, Mazzone, and the public-interest law firm, Washington Legal Foundation, is clear and simple: under no set of circumstances did either have any economic interest in the interest proceeds. Likewise, the response to the claim made by the client, Summers, is clear when the facts established in the trial court are considered under the appropriate state law and the constitutional jurisprudence of this Court. There is no "taking" of "property" where the claimant can point to no financial loss as a result of the action he challenges. Respondent Summers has no cognizable expectation – under any recognized Texas definition of the term "property" – to the interest generated from an IOLTA account.

The Texas IOLTA Program does not violate any traditional, fundamental notion of liberty. Rather, the Texas program, and nearly identical programs in place in virtually every state of the Union, are an ordinary and entirely appropriate exercise of sovereign state power affecting no legitimate interest of the Respondents.

ARGUMENT

Respondents challenge the Order creating the IOLTA program, claiming it so interferes with their interests as to amount to a taking of their property requiring just compensation. Before the Fifth Circuit panel's decision in this case, Respondents and others had attempted identical challenges in other jurisdictions. The First and Eleventh Circuits both concluded that IOLTA programs functionally identical to the Texas IOLTA Program did not effect a taking of any property. Likewise, every state

court of last resort to address the question has arrived at the same conclusion.¹³ This overwhelming majority is plainly correct.

I. RESPONDENTS MAZZONE AND WASHINGTON LEGAL FOUNDATION HAVE NOT BEEN SUBJECTED TO A TAKING, EVEN UNDER THE FIFTH CIRCUIT PANEL'S APPROACH

Not even the Fifth Circuit panel in this case would recognize any property right inuring to Mazzone as an attorney or to the Washington Legal Foundation. Respondent Mazzone complains of a restriction of his freedom of action. He would prefer not to participate in the Texas IOLTA programs because he disagrees with its objectives. Likewise, Respondent Washington Legal Foundation, because of the political and ideological objections of the organization, would prefer that IOLTA programs simply not exist. However, the Just Compensation Clause is strictly a vehicle for indemnity of cognizable economic

¹³ E.g., *Petition by Massachusetts Bar Ass'n*, 478 N.E.2d 715 (Mass. 1985) (finding no affected property interest); *Matter of Interest on Lawyers' Trust Accounts*, 675 S.W.2d 355 (Ark. 1984) ("funds in question are not now available to individual clients, and for practical reasons cannot be made available to them"); *Matter of Interest on Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *Petition of New Hampshire Bar Ass'n*, 453 A.2d 1258 (N.H. 1982) (finding no takings impediment); *Matter of Minnesota State Bar Ass'n*, 332 N.W.2d 151, 158 (Minn. 1982) ("no client has a property interest"); *Matter of Interest on Trust Accounts*, 538 So. 2d 448 (Fla. 1989); see also *Carroll v. State Bar of Cal.*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (Cal. Ct. App. 1984).

injury to property rights of the objecting party. *United States v. 564.54 Acres of Land*, 441 U.S. 506, 512 (1979); *Kimball Laundry Co. v. United States*, 338 U.S. 1, 5 (1949).

Participation in the IOLTA program has not caused any financial loss to Respondent Mazzone. The Texas Rules of Professional Conduct prohibit attorneys from benefiting in any way from their clients' trust accounts. Supreme Court of Texas, State Bar Rules art. X § 9, Tex. Disciplinary R. of Prof. Conduct 1.14 (Vernon Supp. 1993). The propriety of these rules is undisputed. Mazzone is merely required to maintain his clients' funds in a trust account, just as he was before IOLTA. This "burden" is no different in kind from other obligations assumed by virtue of obtaining a license to practice law. See, e.g., *Gentile v. State Bar of Nevada*, 501 U.S. 1030, 1071 (1991) ("lawyers . . . [are] subject to ethical restrictions . . . to which the ordinary citizen would not be"). As Justice Cardozo noted: "[m]embership in the bar is a privilege burdened with conditions." *In re Rouss*, 116 N.E. 782, 783 (N.Y. 1917).

Texas attorneys are required to pay an occupation tax, to maintain a minimum level of competence through participation in continuing legal education programs, and to adhere to the standards of professional conduct promulgated by the Texas Supreme Court. Tex. Tax Code § 191.142 (Vernon 1992); Tex. Gov't Code § 81.113 (Vernon 1988); see also generally Tex. Disciplinary R. of Prof. Conduct (Vernon Supp. 1993). The requirement that attorneys deposit client funds, in which they have no claim of beneficial ownership, in an IOLTA account rather than some other account is no greater burden than any other

obligation imposed upon the profession. Rather, participation in IOLTA is but a small recognition of the Bar's professional obligation to assist in providing meaningful access to our justice system for those members of the public who seek justice but who are unable to afford lawyers to represent them.

Moreover, Respondents Washington Legal Foundation and Mazzone lack standing to object to the way in which the money generated by the IOLTA program is used because they have no interest in the money. "It is the role of courts to provide relief to claimants . . . who have suffered, or will imminently suffer, actual harm; it is not the role of courts, but that of the political branches, to shape the institutions of government in such a fashion as to comply with laws and the Constitution." *Lewis v. Casey*, 116 S. Ct. 2174, 2179 (1996).

II. RESPONDENT SUMMERS HAS NOT EXPERIENCED A TAKING OF HIS PROPERTY BECAUSE OF THE TEXAS IOLTA PROGRAM

The first thing a plaintiff invoking the Just Compensation Clause must show is a loss in connection with some cognizable property interest. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001 (1984); *Pennsylvania Central Transp. Co. v. City of New York*, 438 U.S. 104, 124-25 (1978); *Kimball Laundry Co. v. United States*, 338 U.S. 1, 5 (1949) (holding that claim to compensation under Fifth Amendment must be based on actual loss to the owner rather than gain to the government). Respondent Summers failed utterly to show any such interest below.

The Texas IOLTA Program does not call for or permit lawyers to turn over principal belonging (or even potentially belonging) to their clients. Neither does the IOLTA program authorize lawyers to deposit client funds into an aggregated IOLTA account if the funds are capable of generating net interest for the client's benefit outside of the IOLTA process. Quite to the contrary, IOLTA allows only for the aggregation of client funds if the funds cannot reasonably be expected to generate interest income on their own. Summers, a client of Respondent Mazzone, does not allege, and did not offer proof in the District Court, that Mazzone should have deposited his funds into an individual account. In fact, he admitted that Mazzone informed him that his retainer was most likely incapable of generating net interest. (Summers Affidavit, J.A. at 86). Therefore, under established rules regarding property rights, Respondent Summers did not show that any of his property was taken by the Texas IOLTA Program. Summers can prevail only by successfully urging a new and expanded constitutional protection based on a proper reading of state law establishing property interests.

A. The Expectations of the Property Owner are Important

This Court's takings analysis "has traditionally been guided by the understanding of our citizens regarding the content of, and the State's control over, the 'bundle of rights' that they acquire when they obtain title to property." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1027 (1992). This analysis is necessarily informed by the type of property involved, the extent of the alleged

governmental interference, and the degree to which owners of that type of property reasonably expect governmental regulation of its use. *Id.* 1020-27 (discussing "harmful use" exception to takings claims relating to real property). As the Court explained in *Lucas*: "[t]he property owner necessarily expects the uses of his property to be restricted, from time to time, by various measures newly enacted by the State in legitimate exercise of its police powers; . . . some values are enjoyed under an implied limitation and must yield to the police power." *Id.* at 1027 (quotation omitted).

Traditionally, maximum protection has been afforded to interests in real property. As Justice Scalia wrote for the *Lucas* majority, with respect to personal property, the owner, "by reason of the state's traditionally high degree of control over commercial dealings, . . . ought to be aware of the possibility that new regulation might even render his property economically worthless." *Id.* at 1027-28. This observation is borne out by this Court's holdings. For example, in *Andrus v. Allard*, 444 U.S. 51 (1979), this Court examined regulations promulgated by the Secretary of the Interior that completely prohibited any commercial transaction in certain bird feathers. The plaintiffs were engaged in the business of selling Indian artifacts containing feathers that were gathered before the regulations came into effect. *Id.* at 54. While acknowledging that the regulations effectively prohibited economically beneficial use of the plaintiffs' personal property, the Court nonetheless flatly rejected the plaintiffs' takings claim. This Court's opinion in *Lucas* reaffirmed this holding, but stressed that real property, by virtue of its elevated position in the hierarchy of property interests, is

subject to a different rule. 505 U.S. at 1028 (citing *Andrus*); see also *Jacob Ruppert, Inc. v. Caffey*, 251 U.S. 264 (1920) (rejecting takings claim of owner of alcoholic beverages "on hand at time" of prohibition).

Interests in income potential, as personal property, have been subject to a high degree of governmental control. Unlike rights in real property, or rights in personal property whose value is not inexorably linked with governmental control and regulation, interests in income potential have historically been subjected to a wide variety of restrictions deemed to serve the general welfare and have often not even been regarded as "property." See, e.g., *Featherstone v. Norman*, 153 S.E. 58 (Ga. 1930); *Wollenberger v. Hoover*, 179 N.E. 42 (Ill. 1931); 73 C.J.S. *Property* § 11 (1983). Indeed, as this Court noted in *Andrus*, "the interest in anticipated gains has traditionally been viewed as less compelling than other property related interests." 444 U.S. at 66.

When a client surrenders funds to an attorney, while retaining beneficial interest in the principal, what expectation does that client have to interest income? The answer depends on state law and the rules and regulations concerning banking practices. Absent a showing that state law recognizes a property right which can be realized within the framework of federal banking law, the claim of the client, Summers, must fail.

The only existing state law authority supporting the claim of the client against an IOLTA program is the opinion of the Fifth Circuit in this case. The touchstone of this opinion, and the only point at which the court explicitly refers to Texas authority, is the statement that "Texas

observes the traditional rule that 'interest follows principal,' which recognizes that interest earned on a deposit of principal belongs to the owner of the principal." (Pet. App. 8a). In support of this supposed general rule, the panel cited a 1972 Texas Supreme Court decision, *Sellers v. Harris County*, 483 S.W.2d 242 (Tex. 1972), a case in which a county had sought to retain \$6,000 in accrued interest each month on a massive, unaggregated interpleader deposit while litigation over the principal was resolved.

Because *Sellers* is the only Texas authority upon which the Fifth Circuit relied for its conclusion, it deserves close consideration. Three very simple observations help fix the nature of the Fifth Circuit's analysis: First, the Fifth Circuit distilled Texas law to a "general rule" catch-phrase never used before or since in a Texas case. Second, the court ignored the fact that such a general rule would have some obvious exceptions. Finally, the panel glossed over substantial and material differences in the factual predicate of the only Texas case on which it relied.

Contrary to the Fifth Circuit's statement, the Texas Supreme Court in *Sellers* never once used the phrase, "interest follows principal," whether stated as a "traditional rule" or otherwise. Moreover, while the Fifth Circuit introduced its citation to *Sellers* with an "e.g." signal, implying that other Texas cases also have espoused the "interest follows principal" rule, no other Texas cases exist which directly support this rule.

Second, the Fifth Circuit's declaration that "interest follows principal" is demonstrably wrong, at least if elevated to the level of an absolute legal rule. Consider, for example, an "income-only" trust. A settlor leaves a sum of money in trust, with income distributed to a designated beneficiary during life, and the corpus to another beneficiary on the income beneficiary's death. In such a case, interest does not follow principal. Instead, by the terms of the trust agreement, ownership is divided. See, e.g., *Price v. Austin Nat'l Bank*, 522 S.W.2d 725 (Tex. Civ. App.-Austin 1975, writ ref'd n.r.e.).

Another example is more arcane, but for Texans, much more pervasive. Texas is one of the nation's nine community property states. Suppose that a married depositor in Texas places his separate property in an interest-bearing account which he controls. Applying only the rule that "interest follows principal," one would conclude (wrongly) that the depositor should own all of the interest generated in the account. However, under long-settled rules, now codified, interest on the depositor's funds is owned jointly by the marital estate and may be distributed entirely to the other spouse upon dissolution. Tex. Family Code § 3.63 (Vernon 1993); see also *Commissioner v. Chase Manhattan Bank*, 259 F.2d 231, 239 (5th Cir. 1958) (interest derived from separate property during marriage is community property); *Mortenson v. Trammell*, 604 S.W.2d 269, 275 (Tex. Civ. App.-Corpus Christi 1984, writ ref'd n.r.e.) (same). Even worse, at least from the depositor's point of view, one must keep meticulous records. If the depositor cannot prove exactly how much of the money in the account is separate property principal and how much is attributable to community property interest, the entire sum, interest and principal

alike, will be deemed community property. *Estate of Hanau v. Hanau*, 730 S.W.2d 663, 667 (Tex. 1987). In such a case, the Fifth Circuit's supposed general rule would be stood on its head. Principal would follow interest. In sum, even if Texas did generally accept the notion that "interest follows principal," it would be, at most, a default rule subject to variance by contract (such as an "income only" trust) or by operation of law (such as the Texas community property statutes).

Because the "interest follows principal" rule cannot be a truly universal rule in Texas, the third point becomes crucial. The Fifth Circuit panel, while ostensibly relying on Texas property law as expressed in *Sellers*, did not mention any of the facts of the case, much less attempt to draw factual parallels between the interpleader account at issue in *Sellers* and IOLTA accounts. Instead, the panel simply distilled what it perceived to be the essence of *Sellers* – the questionable phrase "interest follows principal" – and applied the phrase to invalidate the Texas IOLTA Program. The only conclusion that can be drawn from *Sellers* is that, absent some other operation of law, a depositor is entitled to the net interest his funds generate.¹⁴ *Sellers* did not suggest, as the Fifth Circuit has now held, that a principal owner is entitled to interest proceeds that are generated because of a governmental program that aggregates otherwise dormant funds.

¹⁴ The court in *Sellers* did not suggest that the owner of interpleaded funds was entitled to all of the interest earned, only that portion in excess of the cost to the county in handling the funds.

B. The Fifth Circuit Panel's Approach Misreads this Court's Takings Jurisprudence and Miscomprehends the IOLTA Program

The Fifth Circuit panel also relied on this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), and identified a right, extant under the Fifth and Fourteenth Amendments, to IOLTA interest income on aggregated sums. Several judges vehemently dissented from this conclusion on Suggestion for Rehearing *En Banc*. Pet. App. at 42a-52a. The Fifth Circuit dissenters were correct.

This Court's opinion in *Webb's* did not announce a new immutable rule of property that a takings plaintiff has a property right to interest proceeds that result solely from aggregation with other deposits and as a result of the challenged governmental action. Rather, it merely observed the "usual and general rule" – recognized by Petitioners themselves – that interest generated by an interpleaded sum follows principal, finding a taking where that interest was held by the state *in addition to* a fee "for services rendered." *Webb's*, 449 U.S. at 164-65. The Court "express[ed] no view as to the constitutionality of a statute that prescribes a county's retention of the interest earned, where the interest would be the only return to the county for its services." *Id.* at 165. Thus, contrary to Respondent Summers' suggestion, *Webb's* does not support the conclusion that interest invariably belongs to the individual whose principal played a small role in generating it, especially where that principal could not have generated that interest but for the governmental action he challenges.

The *Webb's* case involved a deposit of \$1.8 million into the registry of the state court after an agreement to purchase the assets of Webb's Fabulous Pharmacies founded upon the discovery of undisclosed debt. While the litigation proceeded, the tendered funds generated more than \$100,000 in interest. When the court appointed a receiver for Webb's that was admittedly entitled to the principal, a dispute arose concerning the rights to the accumulated interest. The court clerk had retained \$10,000 as an "administrative fee," as well as the more than \$100,000 in accrued interest. The Florida Supreme Court affirmed, permitting the county to retain the entirety of the accumulated interest.

This Court began its analysis by noting that "[i]t is at once apparent that Florida's statute would allow Respondent Seminole County to exact two tolls while the interpleader fund was held by the clerk of the court." *Id.* at 159. The first would be the \$10,000 fee "for services rendered" and the second would be the roughly \$100,000 in interest. *Id.* Conceding that the existence of a cognizable property interest turned on state law and the legitimacy *vel non* of the expectation to the proceeds, the Court found that the owners had a reasonable and substantial expectation to the principal and the interest, although it left the \$10,000 fee undisturbed. The Court was careful to note that less drastic exactions meant merely to "adjust the benefits and burdens of economic life in order to promote the common good" could not be deemed a taking, even though a property owner is denied "some beneficial use of his property" or restricted in its full exploitation. *Id.* The Court was also careful to point

out that its holding was limited to "the narrow circumstances of this case - where there is a separate and distinct state statute authorizing a clerk's fee 'for services rendered,' " which it allowed the state to retain. *Id.* at 164.

While this case also involves a claim of entitlement to interest proceeds, the similarities end there. In fact, there are at least three material differences that the Fifth Circuit panel failed to consider.

1. The Webb's Owners Reasonably Expected that Their Principal Would Generate Net Interest Income

Insofar as *Webb's* stands for the proposition that an owner of funds is entitled to interest on interpleaded funds that are capable of and, in fact, do generate net interest, Petitioners agree. In fact, the Texas Supreme Court has so held. *Sellers v. Harris County*, 483 S.W.2d 242 (Tex. 1972). But IOLTA presents a materially different situation. As explained more fully above, *supra* II.A., the expectations of a property owner are crucial to any takings analysis. The *Webb's* claimants had a reasonable expectation that their principal would generate net interest. In fact, their principal generated more than \$100,000 in interest income. In stark contrast, the IOLTA program does not authorize funds to be included into an aggregated IOLTA account if they are capable of generating *any* net interest to the owner.

Viewed against the reasonable expectation of the owner, the claimants in *Webb's* had suffered a loss. They were not seeking interest that would have been eclipsed by the county's cost in setting up the bank account. In

fact, they did not appear to even seek that portion of the interest proceeds that represented the actual cost of creating and maintaining the account. Having tendered in excess of \$1.8 million for deposit under state law into an interest bearing account, there was an obvious and substantial expectation that those funds would generate net interest. The Florida rule prohibited the *Webb's* claimants from receiving any of that interest income. Exactly the reverse is true here: Neither Respondent Summers, nor any other client, has suffered any monetary loss as a result of the IOLTA process. Rather, they see a gain that they could not have realized on their own and wish to claim it as "just compensation."

This Court has repeatedly refused to recognize any entitlement to compensation premised upon the gain realized by the putative taker rather than the actual loss to the Plaintiff. *See, e.g., Kimball Laundry Co. v. United States*, 338 U.S. 1, 5 (1949) ("Because gain to the taker . . . may be wholly unrelated to the deprivation imposed upon the owner, it must . . . be rejected as a measure of public obligation to requite for that deprivation."); *United States v. Causby*, 328 U.S. 256, 261 (1946) (rejecting argument that measure of value of taken property could include taker's gain); *United States v. Miller*, 317 U.S. 369, 375 (1942) (holding that takings plaintiff can recover "no more than indemnity for his loss"). It follows rather naturally that a plaintiff may not hinge his entire takings claim on the presence of a gain to the government, in the complete absence of any economic loss to himself.

Unlike the *Webb's* claimants, Respondent Summers is seeking money that his funds could not earn. He has not seen a decline in the value of his property as a result of

the action he challenges. Thus, he has not suffered a "taking" of his property requiring "just compensation." Cf. *Suitum v. Tahoe Regional Planning Agency*, 117 S. Ct. 1659, 1665 (1997) ("Only takings without just 'compensation' infringe [the Fifth] Amendment.").

2. Clients are Not Charged Twice for Using the Texas Legal System

The *Webb's* claimants were charged \$10,000 for the "service" of having an account opened and were also denied the more than \$100,000 of interest directly attributable to those funds. The *Webb's* opinion leaves no doubt that this attempt at what amounts to double billing for a single service weighed heavily in the Court's analysis and its holding. It should be clear that Respondent Summers was not asked to pay anything when his funds were deposited in an IOLTA account.

3. The IOLTA Program Does Not Create an Incentive to Withhold Principal or Permit Such Abuse to Occur

In its evaluation of the Florida interpleader regime, the Court expressed concern that permitting the state to retain all interest proceeds, including interest in excess of the administrative cost of maintaining the account, created a disincentive for resolution of the underlying legal dispute. "If the County were entitled to the interest, its officials would feel an inherent pressure and possess a natural inclination to defer distribution, for that interest return would be greater the longer the fund is held; there

would be, therefore, a built-in disincentive against distributing the principal to those entitled to it." *Webb's*, 449 U.S. at 162. The IOLTA program creates no such risk. The duration of an IOLTA deposit is entirely within the control of the attorney and his client. Indeed, as noted above, this is why the ethical prohibition against attorneys benefiting from client funds exists. By prohibiting lawyers from earning interest on client trust funds, the rules diminish the possibility of such abuse occurring.

C. Incidental Restrictions on Beneficial Use Do Not Amount to a Violation of the Fourteenth Amendment's Due Process Clause

While Respondents cannot claim to have lost interest income as a result of the Texas IOLTA Program, Respondent Summers claimed below that he had lost the right to exclude others from making beneficial use of his property, which he claims is an integral component of the "bundle of rights" associated with his "title" to money. Indeed, this is a very strange takings argument. It is doubtful that "title" to money includes, as a matter of common law, the right to exclude beneficial use of it by the state. See, e.g., *Washington Legal Found. v. Massachusetts Legal Found.*, 993 F.2d 962, 974 (1st Cir. 1993) (finding no such interest). The argument is especially tenuous in the context of funds that have been tendered to a bank for deposit.

1. Respondent Summers Has Surrendered Control Over the Use of His Funds

A person tendering funds into any bank deposit cannot seriously believe that he has retained the right to exclusive use of them, let alone, to exclude others from making beneficial use of those funds while they are on deposit. If Respondent Summers deposits a one-hundred dollar bill into any bank account – a decision utterly unaffected by the existence of the IOLTA program – he will be sorely disappointed if he appears the next day and demands the same bill back. A bank accepts deposits only because it is able to assume complete control of the money until it is demanded by the depositor. By aggregating depositors' funds and making some beneficial use of them – without consulting with the depositors – the bank hopes to generate returns that will exceed what it has agreed to pay the depositors. This was precisely the point of George Bailey's desperate speech in the lobby of the Bailey Building & Loan during the Bedford Falls' bank scare. *It's A Wonderful Life* (1938) ("You're thinking of this place all wrong, as if I had the money back in the safe. The money's not here. Well, your money's in Joe's house – that's right next to yours – and in the Kennedy house, and Mrs. MacLain's house, and a hundred others."). Regardless of whether Respondent Summers chooses to travel in the circles of the Baileys or the Potters of this world, no bank will hold his currency without the unfettered right to make "beneficial use" of it.

Of course, prior to IOLTA, Respondent Summers had no right to control the use of money that he deposited

with his attorney. It was all placed in a demand account, and the bank, not Mr. Summers, decided what it would do with the interest it earned. The bank could have used that money to facilitate pro bono legal services to the poor without first seeking Summers' permission. The fact that it chose to use the interest it earned to enhance the investment of its stockholders does not alter the constitutional analysis from Mr. Summers' perspective. In all events, Mr. Summers had no right to direct the beneficial use of his deposits before IOLTA. Nothing in the IOLTA rules diminishes his control in any way. Thus, stated either in terms of his property – he had nothing to lose – or his injury – he is no worse off than before, Respondent Summers has no judicially cognizable claim against Petitioners as a result of the adoption of the Texas IOLTA Program.

Indeed, even after IOLTA, if Respondent Summers prefers to retain the exclusive right of beneficial use of his money, he is free to do so, assuming neither his lawyer nor some other third party insists on some other arrangement. Nothing in the IOLTA rules prevents a client from simply placing his money in a safety deposit box in order to prevent others from making beneficial use of it. Of course, that money will earn no interest and the bank will charge him a fee. Nonetheless, he can rest secure in the knowledge that no one has taken his perceived right to prevent a beneficial use of his money. While Petitioners have made no effort to prevent this, it has been discussed elsewhere. See Matthew 25:14-30 (condemning the "wicked and slothful servant" for burying his money).

2. Even Assuming that Respondent Summers' "Right to Exclude Beneficial Use" Exists, Its Denial Would Not Give Rise to A Claim for Just Compensation

Even if one ignores the fact that Summers himself has surrendered his supposed right to prevent beneficial use of his money, governmental regulation affecting the use of property "does not cause a taking unless the interference is significant." *Washington Legal Found.*, 993 F.2d at 976 (citing *Andrus*, 444 U.S. at 66-67). It is undisputed that the IOLTA program does not take any principal. Likewise, it does not deprive Respondents of any interest income that could have been earned in its absence. Where nothing of value is taken, "nothing [is] recoverable as just compensation." *Marion & Rye Valley Ry. Co. v. United States*, 270 U.S. 280, 282 (1926).

To be sure, the common law of real property includes rights of exclusivity that are important in that context. Without the right to exclude others, there is no way for the owner of real property to exercise his rights of possession. Unlike the owner of personal property, he may not simply carry real property away. Thus, the government cannot, for example, require a landowner to dedicate his property to permanent public use. See, e.g., *Dolan v. City of Tigard*, 512 U.S. 374, 384 (1994). That said, even where real property is concerned, the interest in excluding others has never been regarded as so absolute that a minor or temporary deprivation would require compensation. See *State v. Shack*, 277 A.2d 369 (N.J. 1971) (rejecting common-law property right to exclusive use of real property against governmental efforts to provide services to migrant workers located thereon); *Agricultural Labor*

Relations Bd. v. Superior Court, 546 P.2d 687 (Cal. 1976) (same claim rejecting takings).

Even if one generously assumes that the right to exclude the government from beneficial use of money exists as a strand in the "bundle of rights," this Court has already held that denial of a strand in the bundle of personal property rights is not a taking. *Andrus*, 444 U.S. at 66-67; *Webb's*, 449 U.S. at 163. For example, this Court has refused to find a taking where private employers were forced to pay premiums to a government corporation to benefit others, noting that "it cannot be said that the Takings Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another." *Connolly v. Pension Benefit Guarantee Corp.*, 475 U.S. 211, 223 (1986); *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976) (upholding statute requiring mine operators to pay benefits despite absence of any such contract); see also *Truax v. Corrigan*, 257 U.S. 312, 347-49 (1921) (Holmes, J., dissenting). The Just Compensation Clause is not a vehicle for the enforcement of ideology in the absence of concrete injury in the value or actual use of property. See, e.g., *United States v. 564.54 Acres of Land*, 441 U.S. 506, 512 (1979) ("In view . . . of the liability of all property to condemnation for the common good, loss to the owner of nontransferable values deriving from his . . . idiosyncratic attachment to it, like loss due to an exercise of the police power, is properly treated as part of the burden of common citizenship.") (quoting *Kimball Laundry Co.*, 338 U.S. at 5). Rather, as the text of the Clause confirms, it protects the citizen's right to compensation for an economic loss. *564.54 Acres of Land*, 441 U.S. at 512; *Carroll v. State Bar of Cal.*, 166 Cal. App. 3d 1193, 213 Cal.

Rptr. 305 (Cal. Ct. App. 1984); see also Brief of Nat'l Conf. of State Legislatures, et al.

In *United States v. Causby*, the Court found a taking requiring just compensation to result from the flight of multi-engine bombers at a height of 80 feet over the plaintiff's farm, causing his chickens to be killed from "flying into the walls from fright." 328 U.S. at 259. In its holding, the Court emphasized the actual and substantial loss to Causby. The Court rejected the preposterous notion that Causby could have premised his claim on the common-law right to make exclusive use of land to the periphery of the universe. *Id.* At bottom, Respondent Summers is simply retreading this ground.

The stated basis of the claim in this case is not that the challenged action has materially interfered with some profitable use of Respondent Summers' property, but, instead, that Summers objects to someone else's use. In essence, Respondent is standing in the shoes of farmer Causby's distant, grumpy neighbor who keeps no chickens and hears no engines, but merely objects to the notion of aircraft flying through territory that, at common law, belonged to him.

Any interference with Respondent Summers' supposed right to prevent prospective beneficial use of his property simply does not have compensable value. Even when real property has been literally "taken" from its owner, the great weight of authority holds that the value of the prospective use to which the owner might put the property is either not "taken" or does not require compensation. *Pennsylvania Central Transp. Co. v. City of New*

York, 438 U.S. 104, 124-25 (1978) (looking to investment-backed expectations and finding no taking where landowners were prohibited from building in air space above land); *United States v. Petty Motor Co.*, 327 U.S. 372, 377-78 (1946) (rejecting compensation for lost profits or damage to good will).

Money derives its value from its status as legal tender, not from the right to exclusive possession. See, e.g., *Washington Legal Found.*, 993 F.2d at 974 n.10 ("[W]e do not find analogous, intangible property rights which, by their nature or by agreement, require the exclusion of others to preserve the property interest."). Indeed, the entire purpose of money is to create something that is fungible. To the extent that Respondent Summers has some personal and peculiar value associated with preventing others from benefiting from it, that value is not generally recognized and, in any event, has been voluntarily surrendered when he deposits his money in a bank (or directs his lawyer to do so).¹⁵

¹⁵ One doubting that Respondent Summers' supposed right to exclude beneficial use of his money by the government has no compensable economic value might propose the following transaction to any rational person. Withdraw a one-hundred dollar bill from your wallet and tell that person you are offering to sell him, not the one-hundred dollar bill, but the right to exclude the government from making beneficial use of it. Then ask him what he thinks your offer is worth.

* * *

None of the Respondents has suffered any cognizable economic loss as a result of the operation of the Texas IOLTA Program. Respondent Summers has no claim under the Just Compensation Clause for the deprivation of his supposed right to exclude the government from benefiting from his money. At bottom, this challenge to IOLTA is less an effort to recoup any lost income than a challenge based on political ideology going to the very heart of these programs that serve the public good. This is not a takings claim.

By challenging IOLTA, Respondents attack the programs that provide many of America's elderly, its homeless, its sick, and its poor access to our justice system. Notwithstanding Respondents' philosophical objections, when our profession accounts to history in defense of its stewardship of the rule of law, its claim will rest on the extent to which access to justice has been provided to those who cannot afford it. For without public confidence in our justice system, the rule of law cannot survive.

—◆—

CONCLUSION

The Fifth Circuit panel's opinion below is contrary to decisions of two other federal circuits and several state courts of last resort. It rests on a misreading of one decision of this Court and another of the Texas Supreme Court. The result reached is flatly contrary to these decisions, federal banking laws, and this Court's takings jurisprudence. This Court should reverse.

Respectfully submitted,

NANCY TREASE
Office of the Attorney
General of Texas
P.O. Box 12548,
Capitol Station
Austin, TX 78711
(512) 475-4075

Attorneys for Petitioners

*Hon. Thomas R. Phillips,
Hon. Raul A. Gonzalez,
Hon. Nathan L. Hecht,
Hon. John Cornyn, Hon.
Craig T. Enoch, Hon. Rose
Spector, Hon. Priscilla
Owen, Hon. James A.
Baker, Hon. Greg Abbott,
In Their Official Capacities
As Justices Of The Texas
Supreme Court*

DARRELL E. JORDAN*
BRITTAN L. BUCHANAN
DAVID J. SCHENCK
BETH W. BIVANS
HUGHES & LUCE, L.L.P.
1717 Main Street, Suite
2800
Dallas, TX 75201
(214) 939-5500

*Attorneys for Petitioners
Texas Equal Access to Jus-
tice Foundation, And W.
Frank Newton, In His Offi-
cial Capacity As Chairman
Of The Texas Equal Access
To Justice Foundation*

August 25, 1997

* Counsel of Record

OCT 10 1997

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1997

THOMAS R. PHILLIPS, RAUL R. GONZALEZ, NATHAN L.
HECHT, JOHN CORNYN, CRAIG T. ENOCH, ROSE SPECTOR,
PRISCILLA R. OWEN, JAMES A. BAKER, and GREG ABBOTT,
in their official capacities as Justices of the Supreme Court of
Texas; TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION; and
W. FRANK NEWTON, in his official capacity as Chairman of
Texas Equal Access to Justice Foundation,
Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
SUMMERS, and MICHAEL J. MAZZONE,
Respondents.

On Writ of Certiorari
to the United States Court of Appeals
for the Fifth Circuit

BRIEF FOR RESPONDENTS

MICHAEL J. MAZZONE
9 Greenway Plaza
Suite 2300
Houston, TX 77046
(713) 940-6001
Pro Se

DANIEL J. POPEO
RICHARD A. SAMP
(Counsel of Record)
WASHINGTON LEGAL FOUNDATION
2009 Massachusetts Ave, NW
Washington, DC 20036
(202) 588-0302

DONALD B. AYER
THOMAS M. FISHER
JONES, DAY, REAVIS & POGUE
1450 G St., NW
Washington, DC 20005-2088
(202) 879-3939

*Attorneys for Petitioners WLF
and William R. Summers*

Date: October 10, 1997

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QUESTION PRESENTED

Pursuant to the Court's June 27, 1997 order, the question presented by this case is as follows:

Is interest earned on client trust funds held by lawyers in IOLTA accounts a property interest of the client or lawyer, cognizable under the Fifth Amendment of the United States Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could not earn interest for the client or lawyer?

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BRIEF FOR RESPONDENTS

STATEMENT OF THE CASE

This case arises from a suit brought by Respondents in federal district court in Texas. The suit alleges that the Texas IOLTA ("Interest on Lawyers' Trust Accounts") program violates Respondents' rights under the First and Fifth Amendments to the United States Constitution. Petitioners ask the Court to reverse a ruling of the United States Court of Appeals for the Fifth Circuit that interest earned on IOLTA accounts is the "private property" -- within the meaning of the Fifth Amendment's Takings Clause -- of those whose funds are deposited into IOLTA accounts. Petition Appendix ("Pet. App.") 1a-19a.

Attorney Trust Accounts

It is (and has been for centuries) a common practice for attorneys to hold funds belonging to their clients in connection with their practice of law. The experience of Respondent Michael Mazzone is typical of lawyers throughout the nation. Mr. Mazzone "ha[s] determined from experience that as a practical matter [he] cannot operate [his] law practice without collecting client funds" and holding them in trust for his clients. Joint Appendix ("J.A.") 83.

Prior to 1980, a lawyer generally held client trust funds in a non-interest bearing, federally-insured checking account in which all of his/her clients' trust funds were pooled. Pooled accounts provided for administrative convenience and ready access to funds. Such accounts were non-interest bearing because federal law had (since the Depression) prohibited federally-insured banks and savings and loans

from paying interest on *checking* accounts. See 12 U.S.C. §§ 371a, 1464(b)(1)(B), 1828(g). When a client placed a large amount of funds in trust with his attorney, however, such funds were generally placed into interest-bearing *savings* accounts, because the interest generated outweighed the inconvenience caused by the absence of check-writing capability.

Starting in 1980, the combination of gradual relaxation of federal restrictions on interest payments by financial institutions and the improved technology available to those institutions greatly expanded the opportunities available for earning interest on deposited funds. The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (amending various sections of Title 12 U.S.C.) expanded the interest-generating capacity of bank deposits in several crucial ways. In particular, it authorized creation of interest-bearing Negotiable Order of Withdrawal (NOW) accounts, which operate like traditional checking accounts. 12 U.S.C. § 1832. It also withdrew, over a six-year period, most controls over the maximum rate of interest that financial institutions were permitted to pay on savings accounts. 12 U.S.C. §§ 3501-3509.

These and other regulatory changes, coupled with advances in technology, have produced a range of options through which customers are able to earn a market rate of interest on their funds while at the same time enjoying the convenience of check writing. These options include the ability to transfer funds freely among different types of accounts; and to pool the deposits of several individuals in a single account, with the bank computing interest and principal separately for each depositor (a banking service

generally referred to as "sub-accounting"). See, e.g., Affidavit of Robert J. Randell, J.A. 95-105.

Creation of IOLTA Programs

A number of states, beginning with Florida in 1981, moved quickly to establish IOLTA programs in order to take advantage of the income-producing potential created by the decontrol legislation. Under such programs, interest earned on pooled attorney trust accounts is paid to foundations established by state supreme courts, and those foundations in turn distribute funds to groups that hire attorneys who purport to represent the interests of low-income individuals.

The IOLTA program in Texas was created by order of the Supreme Court of Texas effective May 9, 1984. The order, now codified as Article XI of the State Bar Rules, provided that an attorney receiving client funds that were "nominal in amount" or were "reasonably anticipated to be held for a short period of time" was permitted to place the funds into an unsegregated interest-bearing bank account (an "IOLTA account") and to pay interest earned on those funds to a nonprofit corporation to be established by rules to be promulgated by the Supreme Court of Texas. TEX. STATE BAR R. art. XI, § 5, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G app. (Vernon 1984).

To implement Article XI, the Supreme Court of Texas by order dated April 30, 1984 adopted its "Rules Governing the Operation of the Texas Equal Access to Justice Program" (the "IOLTA Rules"). J.A. 108-125. The IOLTA Rules established Petitioner Texas Equal Access to Justice Foundation ("TEAJF") as the nonprofit corporation that was to receive funds paid into the IOLTA program. Consistent

with Article XI, the IOLTA Rules specified that funds forwarded to TEAJF from IOLTA accounts were to be awarded as grants solely to nonprofit organizations that "have as a primary purpose the delivery of legal services to low income persons." J.A. 116.

During the first four years of operation of the IOLTA program (1985-88), funds forwarded from IOLTA accounts to TEAJF never exceeded \$1 million per year. On December 13, 1988, the Supreme Court of Texas amended Article XI and the IOLTA Rules to make participation in the Texas IOLTA program mandatory. Pursuant to the amended Article XI and the amended IOLTA Rules, attorneys in Texas who "hold client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time" *must* place the funds in an unsegregated "interest-bearing insured depository account," with interest earned thereon to be paid to TEAJF. Rule 4, J.A. 111.

The issue of whether client trust funds "are nominal in amount or held for a short period of time," and thus required to be placed in IOLTA accounts, is addressed by Rule 6 of the IOLTA Rules. Rule 6 requires funds to be placed in IOLTA accounts:

[I]f such funds, *considered without regard to funds of other clients which may be held by the attorney*, law firm or professional corporation, could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for

the client. Also to be considered are the nature of the proceeding or transaction involved and the likelihood of delay in the need for such funds in such proceeding or transaction. (Emphasis added.)¹

The IOLTA Rules provide for severe enforcement measures against any attorney who fails to comply with IOLTA program requirements. For example, Rule 24 provides for the automatic suspension of the law license of any attorney who fails to submit an annual "compliance statement" certifying that he is maintaining an IOLTA account in accordance with the IOLTA Rules. J.A. 122-123. On the other hand, Article XI, § 7 and Rule 23 both provide immunity to attorneys who act "in good faith" in determining whether to place client trust funds in IOLTA accounts.

The switch from a voluntary to a mandatory IOLTA program became effective as of July 1, 1989. As a result of that switch, interest income generated by the Texas IOLTA program has increased several-fold -- to nearly \$10 million dollars in its highest year (1991). Nationwide, IOLTA pro-

¹ As is discussed in more detail below (*supra* at 39 n.15), TEAJF's interpretation of the highlighted language has changed during the course of this litigation. TEAJF officials for many years interpreted that language as requiring the maintenance of a separate account for each client whose funds the attorney desired to keep outside the IOLTA program. That separate-account requirement precluded placement of client trust funds into pooled non-IOLTA, interest-bearing accounts, with the bank providing sub-accounting services that keep track of each client's share of the account. (Such sub-accounting can significantly reduce the per-client administrative cost of maintaining trust accounts. J.A. 97-100.) In the court of appeals, Petitioners adopted a new interpretation of Rule 6; they now interpret Rule 6 as permitting sub-accounting in connection with non-IOLTA trust accounts, provided that use of such accounts is otherwise permissible under the Rule. Fifth Circuit Brief of TEAJF and Newton at 7-8.

grams generate in excess of \$100 million per year (Pet. Br. at 3), indicating that on a typical day in excess of \$5 billion in client funds is being held in IOLTA accounts.

Respondents' Relationship with the IOLTA Program

Respondents in this action are an attorney licensed to practice law in the State of Texas; a citizen of Texas who currently has funds being held in an IOLTA account; and a public interest law firm, the Washington Legal Foundation.

The Texas lawyer is Respondent Michael J. Mazzone. In accordance with Article XI and the Rules, Mr. Mazzone maintains an IOLTA account into which he regularly deposits client funds that are (as defined by Rule 6) either nominal in amount or are reasonably anticipated to be held for a short period of time. J.A. 83.

The Texas citizen with funds currently being held in a Texas IOLTA account is Respondent William J. Summers. Mr. Summers is a businessman whose work requires him to make regular use of the services of attorneys. J.A. 85. In December 1992, Mr. Summers was named as a defendant in civil litigation. J.A. 86. Pursuant to the agreement under which he hired an attorney to represent him, Mr. Summers paid the attorney a small retainer. *Id.* The litigation is ongoing, and the attorney continues to hold the retainer. *Id.* In January 1994, Mr. Summers learned for the first time that his attorney had deposited the retainer into his law firm's IOLTA account and that all interest earned on that account is paid to TEAJF to support Texas's IOLTA program. *Id.*

Proceedings Below

Respondents filed this action on February 7, 1994 in U.S. District Court for the Western District of Texas, alleging that the IOLTA program violated their rights under the First Amendment (by compelling them to financially support speech with which they disagree) and the Fifth Amendment (by taking their property without compensation). Named as defendants were TEAJF; W. Frank Newton, in his official capacity as Chairman of TEAJF; and the nine Justices of the Supreme Court of Texas (the "Justices"), in their official capacities as members of that court.

In a Memorandum Order and Judgment dated January 19, 1995, the district court granted Petitioners' motions for summary judgment and denied Respondents' motion for summary judgment. Pet. App. 20a-40a. The court found that the only funds eligible for deposit in an IOLTA account are those *incapable* of earning "net interest" (that is, interest after deduction of costs associated with maintaining an interest-bearing account) "if deposited by themselves in an individual (non-pooled) account" (*id.* at 29a) or if deposited in a pooled account offering sub-accounting. *Id.* at 24a n.2. The court reasoned that Respondents could have no "reasonable expectation" of earning interest on such funds and thus have no "property interest in interest proceeds that, but for the IOLTA Program, would never have been generated." *Id.* at 30a. Without such a property interest, the court concluded, Respondents could not state a Fifth Amendment taking claim based on TEAJF's appropriation of the interest proceeds. *Id.*

The district court rejected Respondents' First Amendment compelled speech claim on similar grounds. *Id.* at 34a-37a. Such a claim, the court stated, "is necessarily predicated upon" the assertion that "the funds generated from the IOLTA accounts are, in fact, the property of the client." *Id.* at 35a. Because the court had held that the interest generated by the IOLTA program was not the property of any of the clients, Respondents could have no First Amendment claim that they were forced to support speech they found objectionable. *Id.* The court likewise held that forcing attorneys to participate in the IOLTA program does not violate their First Amendment rights. *Id.* at 36a-37a.²

The court of appeals reversed the grant of summary judgment for Petitioners and remanded the case to the district court for further proceedings. *Id.* at 1a-19a. Labeling the IOLTA program a "modern-day attempt at alchemy" that seeks to create property from nothing (*id.* at 7a), the appeals court concluded that "it seems obvious that the interest earned in the IOLTA accounts is the property of the clients whose money is held in those accounts." *Id.* at 8a. Citing *Sellers v. Harris County*, 483 S.W.2d 242, 243 (Tex. 1972), the court stated, "Texas observes the traditional rule that 'interest follows principal,' which recognizes that interest earned on a deposit of principal belongs to the

² The court also rejected Respondents' alternative Fifth Amendment argument that TEAJF -- by using Respondents' funds without permission for purposes of generating IOLTA funds -- was violating their right to exclude others from the beneficial use of their funds. *Id.* at 32a-33a. While noting that this Court on numerous occasions has recognized the principle that the right to exclude others from one's property is an important strand in the bundle of rights that constitute "property," the district court held that the right to exclude others is fully applicable to "real or tangible property" only, not to "intangible property" such as money. *Id.*

owner of the principal." Pet. App. 8a. The court also relied on *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), which it said mandated a finding that -- for purpose of Takings Clause analysis -- interest earned on IOLTA accounts must be deemed the property of those whose principal generated the interest. Pet. App. 12a.

The appeals court rejected Petitioners' argument that clients lack cognizable property rights in IOLTA interest because of their alleged inability to derive benefit from funds held in non-IOLTA trust accounts; the court said that *Webb's* "creates a rule that is independent of the amount or value of interest at issue." Pet. App. 12a. The court also said that the inability of some bank deposits to generate "net interest" was largely a result of features of the tax law, such as the requirement that all recipients of interest income be sent IRS Form 1099. *Id.* at 16a-17a n.47. The court said that the existence of a Fifth Amendment property right in interest income should not "hinge . . . on the fickle tax code," particularly since costs associated with operating small bank accounts are subject to rapid change. *Id.*

The appeals court remanded the case to the district court "for reconsideration in the light of the principles explained in this decision and for further factual development of the record." *Id.* at 17a.³

³ The appeals court did not reach the ultimate issue of whether Petitioners' appropriation of interest generated by IOLTA accounts violated the Takings Clause. The appeals court's order vacating the grant of summary judgment for Petitioners revived Respondents' First Amendment claims as well, but the court's decision contains virtually no mention of those claims. Nor did the court address Respondents' alternative Fifth Amendment argument: that TEAJF was violating their right to exclude others from the

(continued...)

On June 27, 1997, this Court granted review with respect to the first of two questions presented in Petitioners' certiorari petition. The Court agreed to consider whether interest earned on client trust funds held by lawyers in IOLTA accounts is a property interest of the client or lawyer, cognizable under the Fifth Amendment.⁴ The Court declined to review the second question presented in the petition: whether the court of appeals had improperly applied principles of federal general common law.

SUMMARY OF ARGUMENT

Petitioners may not escape Fifth Amendment scrutiny of the Texas IOLTA program on the ground that Respondents lack property rights in interest paid on their money. As this Court has repeatedly recognized, the earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property. The "interest follows principal" rule flows naturally from the understanding of the nature of interest that has prevailed in Western society since the Reformation. Further, the rule that "interest follows principal" has been recognized in the common law for centuries and in the courts of all states that have addressed the issue, including the State of Texas. The

³(...continued)
beneficial use of their funds.

The appeals court also affirmed that portion of the district court's order that held that TEAJF is an arm of the State of Texas and thus is entitled to Eleventh Amendment immunity with respect to Respondents' claims for monetary damages. *Id.* at 17a-19a.

⁴ The Court revised Petitioners' rendition of the question presented to delete any reference to Respondents' First Amendment claims. J.A. 107.

rule is fully applicable regardless whether the owner of the property had a right to insist that interest be generated by his funds, regardless of the amount of interest at issue, and regardless whether the owner had a "reasonable, investment-backed" expectation of receiving interest.

The State of Texas may not evade Takings Clause review of its conduct by declaring that Texas law no longer recognizes property rights in income derived from small attorney trust accounts. It is true that property rights are, to a large extent, creatures of state law; but the Constitution imposes strict limits on the power of states to redefine traditional property rights. The Takings Clause was intended to prevent states from arbitrarily transforming private property into public property, even when it does so for a limited time only and regardless whether the property is already subject to extensive government regulation.

The Fifth Circuit's reversal of the grant of summary judgment was proper for the additional reason that virtually all clients would benefit financially if their funds were excluded from the IOLTA program. The factual premise underlying Petitioners' Question Presented -- that it is a "fundamental precept" of IOLTA that the only funds in the IOLTA program are those that could not earn interest for the client -- is demonstrably false. Any amount of money is capable of generating bank interest in a pooled account. It is true that in *some* instances the interest earned will be less than the lawyer's costs of administering that money. But the administrative costs of maintaining a non-IOLTA account are no higher than the administrative costs of maintaining an IOLTA account. The net result of the requirement that such funds must (in most instances) be placed in an IOLTA account is that interest generated by the client's funds is paid

to TEAJF rather than being used to defray the costs of maintaining the trust account.

Petitioners' argument that IOLTA interest is not the "private property" of clients -- within the meaning of the Takings Clause -- hinges entirely on their claim that accounting costs make it impracticable for interest to be generated on nominal and/or short-term funds. To the extent such a claim may once have been plausible, it clearly is no longer plausible in view of the explosion in new computer technology over the past two decades.

ARGUMENT

The issue before the Court is whether a client whose money is placed in an IOLTA account by his lawyer has a property interest in the income it generates while in that account. This question should be answered in the affirmative for a simple reason that has been explicitly recognized by this Court, and by many others: Interest is an inseparable incident of the principal for whose use it is paid. Just as the client has a property interest that would support suit against any governmental effort to deny the return of his principal, so he has a claim to the interest paid for the use of that principal. Governmental actions appropriating various types of interest in property may or may not be valid, depending on the authority and circumstances under which the government acts. But there can be no doubt that the owner of a fund has a property right in the income generated by the fund; government efforts to appropriate that income are thus subject to review under the Takings Clause.

Petitioners are understandably reluctant to focus directly on the narrow question before the Court. Thus, they flatly misstate the question presented as reaching the ultimate merits issue whether the IOLTA program results in a compensable taking.⁵ Notwithstanding the clarity of this Court's grant of certiorari, Petitioners' supporting *amici* likewise devote their greatest attention to this issue.⁶ Of course, the ultimate question of whether there has been a taking has not been decided by the courts below; that issue was to have been the subject of proceedings in the district court upon remand from the Fifth Circuit. Pet. App. 17a.

⁵ In their Statement of the Case, Petitioners falsely assert that "certiorari was granted to review the question whether IOLTA programs interfered with property rights in ways that violated either the First or the Fifth Amendments." Pet. Br. at 13. Likewise, in their Summary of Argument and Argument, they argue repeatedly that "[t]he Texas IOLTA program does not take 'property' from anyone." *Id.* at 13, 14, 18. So central is this point to their brief that the claimed failure of the IOLTA Program to effect a taking is made the focus of their two principal argument headings. *Id.* at 15, 17. In addition, they include seven pages in their brief addressed to the issue whether denial of the right to exclude others from the use of their property constitutes a taking -- an issue plainly not included within this Court's grant of certiorari. *Id.* at 29-35.

⁶ For example, *amici* argue that clients surrender control over the use of their principal when they deposit it into any bank account, and thus cannot complain about the character of the uses to which their principal is put, ABA Br. at 13, Br. of Massachusetts Bar Foundation at 11; that the "character of the governmental action" at issue here was merely regulatory and not a physical invasion, Br. of the American Association of Retired Persons ("AARP") at 13; Br. of the Columbus Bar Association ("Columbus") at 13-15; and that Respondents have suffered no adverse impact on reasonable investment-backed expectations, since historically, prior to IOLTA, nominal and short-term client deposits were deposited into non-interest-bearing accounts, U.S. Brief at 12-15, AARP Br. at 12, Columbus Br. at 13-15.

As to the question actually presented respecting a client's property rights in the interest a bank pays for the use of his principal, Petitioners and their *amici* offer little but a *reductio ad absurdum* of "the new property." See Charles Reich, *The New Property* 73 YALE L.J. 733 (1964). They begin with the well-established premise that state law may create expectations of government-conferred benefits amounting to constitutionally protected property rights. See Pet. Br. at 20; U.S. Br. at 9-10 (citing *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972)). Working backward from that proposition, they appear to suggest that even the most fundamental forms of property rights -- like interest income, and presumably even the principal that produces it -- may be undermined and ultimately destroyed by a maze of regulation that sows confusion and undermines the expectations that a party would otherwise reasonably possess.⁷ By

⁷ The reasoning of *Roth* does not justify such a conclusion. *Roth*, of course, involved the question of when governmental actions should be viewed as affirmatively creating property. *Roth*, 408 U.S. at 576-77. *Roth* requires a legitimate claim of entitlement before a property interest in a government benefit can be recognized. *Id.* at 577. In such cases, the Court must examine closely state and federal rules and regulations to determine whether a protectible property interest exists. See, e.g., *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 428-431 (1982)(property interest in claim brought under Illinois Fair Employment Practices Act); *Memphis Light, Gas and Water Div. v. Craft*, 436 U.S. 1, 9-12 (1978)(property interest in continued electric service); *Mathews v. Eldridge*, 424 U.S. 319, 332 (1976)(property interest in continued receipt of social security disability benefits).

In a variety of contexts, however, including Takings Clause and due process cases, the Court generally has found it unnecessary to engage in a detailed *Roth*-style analysis of whether traditional forms of property qualify as constitutionally protected property interests. See, e.g., *Babbitt v. Youpee*, 117 S. Ct. 727 (1997)(owner's right to direct descent of real property);
(continued...)

that sleight of hand, Petitioners would allow government to accomplish the regulatory deconstruction -- and subsequent appropriation -- of every kind of traditional property right in a manner that forecloses review by a court.

Specifically, Petitioners rely on IOLTA's "precept" that funds should only be deposited which, when considered alone, "could not reasonably be expected to earn interest for the client." IOLTA Rule 6, J.A. at 113-14; see Pet. Br. at 6-7. Ignoring the vague and confusing nature of the pertinent regulations, Petitioners thus argue that the client, by definition, can have no expectation of benefit from the interest on his principal, and can therefore claim no property right in that interest. Indeed, Petitioners claim that the IOLTA program "generate[s] interest on otherwise unproductive funds . . .," Pet. Br. at 6, and the Solicitor General is so bold as to assert that the interest earned on IOLTA accounts is "a government-created value." U.S. Br. at 20. It is inconsequential to Petitioners and their *amici* that the interest is the direct product of the client's principal.

Petitioners thus state what they perceive to be the relevant legal inquiry: "When a client surrenders funds to an attorney, while retaining beneficial interest in the

⁷(...continued)

Concrete Pipe & Prod. of California, Inc. v. Constr. Laborers Pension Trust for S. California, 508 U.S. 602 (1993) (\$268,168.81 penalty for pension plan withdrawal); *McKesson Corp. v. Div. of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 36 (1990)(money paid for tax); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001-1004 (1984)(trade secret).

As in *Webb's*, this case does not concern government-conferred benefits, but rather an effort by the government to appropriate a traditional form of property.

principal, what expectation does that client have to interest income?" Pet. Br. at 20. The issue before the court, however, addresses not the right to "income potential" or *anticipated* earnings, but to *actual* earnings -- to the bank's actual payment for the use of clients' deposits that the Texas IOLTA program appropriates to the State of Texas. The relevant expectation to be examined is that of a depositor whose principal has, in fact, earned interest. The economic history of interest and interest rates, this Court's jurisprudence, and the common law of many states all show that when, as here, interest is paid for the use of the principal, the owner of the principal has a long-recognized and legitimate expectation that the interest belongs to him.

I. THE OWNER OF CAPITAL HAS A LEGITIMATE EXPECTATION OF RECEIVING ANY VALUE THAT MAY BE PAID BY OTHERS FOR THE USE OF THAT CAPITAL

A. Present Practice and History Make Clear That Interest Is Compensation Paid to the Owner of Money for Allowing Its Use by Another

In today's world, the use of credit is commonplace, and we take it as a given that interest is compensation a borrower pays to a lender for the use of the lender's money for an interval of time. Nor is this understanding especially recent. As the economist Eugene von Böhm-Bawerk observed in 1884:

[W]hoever is the owner of a capital sum is ordinarily able to derive from it a permanent net income which goes under the scientific name of interest in the broad sense of the term.

* * * *

It arises independently of any personal act of the capitalist. It accrues to him even though he has not moved a finger in creating it, and therefore seems in a peculiar sense to arise from capital or, to use a very old metaphor, to be begotten by it.

Eugene von Böhm-Bawerk, *Capital and Interest* 1 (George D. Huncke & Hans Sennholz trans., 1959). That fact in itself gives rise to the expectation of any lender that, absent some other disposition that he may make, the interest a borrower pays for the use of his principal belongs to him as an incident of the principal itself. But the historical roots of that expectation also merit discussion here: they embody a centuries-long debate in which the propriety of paying the lender for the use of his money overcame religious and philosophical objections to achieve universal acceptance in recent centuries.

The extension of credit in exchange for the payment of interest is not a modern invention. "Loans at interest may be said to have begun when the Neolithic farmer made a loan of seed to a cousin and expected more back at harvest time." Sidney Homer and Richard Sylla, *A History of Interest Rates* 3 (3d ed. 1991). These earliest loans were made for productive purposes. Loans of seed yielded an increase of seeds, a portion of which could be returned with the principal. Loans of animals often yielded offspring, all or some of which could be returned with the animal. Similarly, loans of land could bear an obvious source of interest -- the first fruits of the land. *Id.* at 18-19. As recorded history progressed, there developed an increasing reliance upon credit as a means of paying for capital goods

that could themselves be used to produce income. And some form of payment to the lender as an inducement was often a central element of the transaction. *Id.* at 20-48.

Charging interest on loans has been regulated since ancient times; the practice was long criticized and sometimes banned by both secular and religious authorities. The ancient Israelites forbade charging interest, and the Romans prohibited interest in transactions between Romans. It was likewise opposed by the early Christian Church. Irving Fisher, *The Rate of Interest* 4 (Richard P. Brief ed., 1982); Homer and Sylla, *supra*, at 70.

The early opposition to usury centered on the notion of the sterility of money, which traces back to Aristotle. He observed that the Greek word for usury was also the word for offspring and argued against the nature of interest on the ground that money could not have offspring. Fisher, *supra*, at 4; Homer and Sylla, *supra* at 71. Money was intended only to be used as a medium of exchange, according to Aristotle, and charging interest was unnatural. Böhm-Bawerk, *supra*, at 10.

In the thirteenth century, the Scholastics articulated a view of usury that built on Aristotle's perceptions. In view of the supposed unproductiveness of money, their opposition was tied closely to the very definition that these writers gave to usury: "where more is asked than is given." Homer and Sylla *supra*, at 70; *see also*, Böhm-Bawerk, *supra*, at 14. Notwithstanding these condemnations -- which held substantial sway in secular legislation, Böhm-Bawerk, *supra*, at 16 -- the extension of credit in return for compensation persisted during the Middle Ages. Fisher, *supra*, at 5; Böhm-Bawerk, *supra*, at 11. There were in the late Middle Ages

numerous recognized exceptions to the ban on demanding compensation for lending money. Pawnshops, banks, and some money-lenders were expressly licensed. *Id.* at 17; Fisher, *supra*, at 5. Other practices, such as buying annuities (or "census" interests) in the fruits of land, and taking (and using) land in mortgage for money loaned, required implicit toleration of interest. Böhm-Bawerk, *supra*, at 17; Homer and Sylla, *supra*, 75.

Perhaps of greatest significance in contributing to the widespread acceptance of charging for the use of money was the recognition of a concept of "interest" as distinct from usury. While usury was understood as the payment back to the lender of more than was given, the distinct concept of *interesse*, which anglicized into "interest," derived from the Latin verb, *intereo*, meaning "to be lost." *Id.* at 73. While it was still assumed that the loan itself was to be made without charge, a practice developed, with the approval of both Church and secular authorities, of imposing a fine for the borrower's culpable delay (*mora*) in making timely payment. This fine, or *interesse*, was intended to compensate the lender for the harm suffered as a result of the lender's delay. Fisher, *supra*, at 5. Ultimately, the need to prove the wrongful conduct and the extent of the resulting loss were avoided by the use of two contract clauses -- one which released the lender from the burden of proving *mora*, and one which agreed upon a definite amount to be paid in indemnification. Thus interest became payable simply upon the showing of the delay in making payment, with separate fines agreed to for each period of delay. Böhm-Bawerk, *supra*, at 17; Fisher, *supra*, at 5.

"Interest" thus began to be viewed as compensation for the temporary loss of use of one's money, rather than an

unfair demand to be paid more than one had given. The French jurist Carolus Molinaues, writing in 1546, pointed out in detail how in almost every loan the lender experiences a loss – or “*interesse*” – whose compensation by the borrower is just and reasonable. He observed that the lender generally has a choice with regard to the money that he lends. Instead of lending it, he might elect to purchase land on which to grow crops, in which event he would receive the benefit of the land’s bounty. Böhm-Bawerk, *supra*, at 20. Interest on the loan, then, is nothing more than a form of compensation for the loss suffered by the lender as a result of forgoing his own investment of the money. John Calvin, writing at roughly the same time, advanced similar arguments, asserting that lending at interest can be mutually beneficial to both the lender and the borrower. Harold J. Grimm, *The Reformation Era* 476 (2d ed. 1973).

It was precisely this mutually beneficial character of loan transactions that brought them into widespread use in post-Reformation Europe. In commercial centers, transactions involving interest became commonplace, and secular legislation condemning them yielded to practical necessity. With this as backdrop, in the Netherlands during the mid-seventeenth century, Claudius Salmasius articulated a comprehensive theory of interest that viewed it simply as compensation for the use of the money lent. He also undertook a systematic refutation of the canonist arguments against interest. In both respects, his contentions were well received by the commercial society in which he wrote. Böhm-Bawerk, *supra*, at 23-25.

Since the rise of capitalism -- and the attendant widespread reliance on commercial credit -- that accompanied the Reformation, there has ceased to be a serious question that

interest in some form (albeit often subject to regulation) would generally be accepted. The proposition that interest is a form of compensation paid to the lender by the borrower for the use of money has become fundamental and beyond serious dispute. This Court has recently acknowledged as much. *Smiley v. Citibank*, 116 S. Ct. 1730, 1735 (1996) (“Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money or as damages for its detention,” quoting *Brown v. Hiatts*, 15 Wall. 177, 185 (1896)). From that proposition arises the necessary conclusion that interest paid is property *ab initio* of the lender.

B. The Force of This Basic Economic Principle Has Been Recognized Universally by the Courts

In determining that interest is the property of the party for the use of whose funds it is paid, the court below was not establishing some new rule of federal common law. Rather, the court was following a long-established common-law rule, adopted by Texas, that derives from an understanding of the economic principles described above.

The “interest follows principal” rule has been established under English common law since at least the mid-1700’s. See *Beckford v. Tobin*, 1 Ves. Sen. 308, 27 Eng. Rep. 1049 (1749) (“interest shall follow the principal, as the shadow of the body”). Every state court that has addressed the issue has adopted the rule without reservation.⁸ Prior to

⁸ See, e.g., *Duren v. State*, 507 So.2d 111 (Ala. Crim. App. 1986); *Breda Construzioni Ferroviarie S.P.A. v. Los Angeles County Metropolitan Transp. Auth.*, 56 Cal. App. 4th 1433 (1997); *Burnett v. Brito*, 478 So.2d (continued...)

the advent of IOLTA, Texas courts never displayed any hesitancy in adopting the "interest follows principal" rule. *Sellers v. Harris County*, 483 S.W.2d 242, 243 (Tex. 1972)("The interest earned by deposit of money owned by the parties to the lawsuit is an increment that accrues to that money and to its owners."); *Lawson v. Baker*, 220 S.W. 260, 272 (Tex. Civ. App.- Austin 1920, writ ref'd).

That principle has been repeatedly recognized in the decisions of this Court, beginning with *Himely v. Rose*, 9 U.S. (5 Cranch) 313, 319 (1809)(Johnson, J., dissenting) ("In equity, interest goes with the principal, as the fruit of the tree."), and continuing through *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980). In *Webb's*, the Court held that "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Id.*

Webb's concerned interest generated by funds that had been deposited into the registry of a Florida court by the

⁸(...continued)

845 (Fla. App. 1985); *Puckett v. Walker*, 21 S.E.2d 713 (Ga. 1942); *Kiernan v. Cleland*, 273 P. 938 (Idaho 1929); *B&M Coal Corp. v. United Mine Workers*, 501 N.E.2d 401 (Ind. 1986); *Rhea v. Brewster*, 107 N.W. 940 (Iowa 1906); *Vansant v. State*, 53 A. 711 (Md. 1902); *Adams v. Williams*, 52 So. 865 (Miss. 1910); *State Highway Comm'n v. Spainhower*, 504 S.W.2d 121 (Mo. 1973); *Siroky v. Richland County*, 894 P.2d 309 (Mont. 1995); *Bordy v. Smith*, 34 N.W.2d 331 (Neb. 1948); *State v. Erie*, 42 A.2d 759 (N.J. Super. 1945); *McMillan v. Robeson County*, 137 S.E.2d 105 (N.C. 1964); *Eshelby v. Cincinnati Bd. of Educ.*, 63 N.E. 586 (Ohio 1902); *Thompson v. Territory*, 62 P. 355 (Okla. 1900); *Southern Oregon Co. v. Gage*, 197 P. 276 (Ore. 1921); *Kann v. Kann*, 103 A. 369, 371 (Pa. 1918); *State v. Schamber*, 165 N.W. 241 (S.D. 1917); *State v. McLemore*, 37 S.W.2d 103 (Tenn. 1931); *Heck & Paetow Claim Service, Inc. v. Heck*, 286 N.W.2d 831 (Wis. 1980).

buyer of an insolvent company.⁹ The court in turn deposited the funds in an interest-bearing bank account. Acting in accordance with a state statute, the clerk of the court deemed interest earned on the account to be property of the court. *Id.* at 158. This Court recognized that fund claimants had no absolute right to payment of interest because they had no right to insist that the registry funds be deposited in an interest-bearing account. *Id.* at 161-162. The Court nonetheless held that, for purposes of Takings Clause analysis, any interest actually earned should be deemed the property of the fund claimants. *Id.* at 161. *See also*, *United States v. Mosby*, 133 U.S. 273, 286 (1890)(trustee "was not required to put the funds out at interest, but if he did so, the accretion belonged to the [trust beneficiary]").

Petitioners and their supporting *amici* repeatedly cite the statement in *Webb's* that "a mere unilateral expectation or an abstract need is not a property interest entitled to protection." *Webb's*, 449 U.S. at 161. But surely, in light of the universal acceptance -- both in Texas and elsewhere -- of the common law rule that the earnings of a fund are property just as the fund is property, Respondents' desire to retain the

⁹ The buyer was acting pursuant to the Florida Bulk Transfers Act, Fla. Stat. § 676.106(4) (1977), which permitted buyers of insolvent companies to protect themselves by filing an interpleader complaint in state court and depositing the entire purchase price with the court registry. The law provided that once an interpleader action was filed, those with claims against the insolvent company were required to seek compensation from the interpleaded fund rather than from the buyer. 449 U.S. at 156 & n.2. In *Webb's*, nearly 200 creditors ended up filing claims against the fund. *Id.* at 157.

interest earned on their funds cannot be deemed a "unilateral expectation."¹⁰

In an effort to distinguish *Webb's*, Petitioners attempt to contrast the amount of interest at stake there (approximately \$100,000) with the interest generated by each attorney participating in the Texas IOLTA program. Pet. Br. at 26-27. Petitioners fail to mention, however, that there were 200 claimants to the interest at stake in *Webb's*, 449 U.S. at 157, and the Court never suggested that Florida might withhold interest from those creditors with small claims on the ground that such creditors could not have generated net interest on their own. Indeed, this Court has squarely rejected creation of a *de minimis* exception to the Takings Clause: when the government appropriates private property for itself, compensation is required "no matter how minute the intrusion, and no matter how weighty the public purpose behind it." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992).

In support of Petitioners' position, the United States cites a series of Takings Clause cases in which the Court has

¹⁰ Respondents' expectation that they would receive interest generated from their funds was, in fact, greater than the expectation of the plaintiffs in *Webb's*. Petitioners have never contested that clients who place funds in trust with their attorneys are the sole equitable owners of those funds. In contrast, at the time that the fund at issue in *Webb's* was generating interest, the plaintiffs had merely filed claims against the fund, and their claims had not yet been acted upon in state-court interpleader proceedings. This Court nonetheless recognized that the plaintiffs' expectations that they eventually would receive a distribution from the interpleaded fund if their claims were allowed, and that they would receive a proportionate share of any interest generated by the fund (despite a state statute to the contrary), were property rights cognizable under the Takings Clause. 449 U.S. at 161-162.

considered how to compute the value of real property taken by the government. U.S. Br. at 19-24. These cases stand generally for the proposition that the value of real property taken by the government should be computed based on the loss suffered by the property owner, not the benefit derived by the government. See, e.g., *United States v. Miller*, 317 U.S. 369, 375 (1943); *Olson v. United States*, 292 U.S. 246, 255 (1934).¹¹ None of those cases are relevant to the issue now before the Court: whether the interest earned on IOLTA accounts is the property of those whose property generated the interest. If, as *Webb's* indicates, the interest *is* the property of IOLTA depositors and a compensable taking has occurred, then there should be little difficulty placing a value on what is at stake: it is the amount of the interest paid by the bank and taken by the government.¹²

¹¹ The argument of the United States that IOLTA programs are profitable because Texas and other states have added value and that "IOLTA interest is the product of the government's pooling of funds" (U.S. Br. at 20) suggests a fundamental misunderstanding of how IOLTA programs operate. Texas does not engage in any "pooling of funds." Rather, it is individual attorneys who pool their client trust funds in a single account. The sole role played by Texas is to demand that interest earned on such accounts be given to TEAJF rather than being used, for example, to defray the costs of operating the account.

¹² The United States also argues that IOLTA interest is not the property of IOLTA depositors because they had "no reasonable, investment-backed expectation that their funds would generate interest." U.S. Br. at 12-19. That argument is based on a misreading of relevant case law. The concept of "reasonable, investment-backed expectations" comes into play, if at all, in determining whether government *regulation* of private property is compensable under the Takings Clause. See, e.g., *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005-1006 (1984). That concept is irrelevant to the antecedent determination of whether the claimant has cognizable property rights in the property at issue. *Id.* at 1001.

(continued...)

Respondents recognize that when the government is administering a fund, it is permitted to charge a reasonable fee for its services. *Webb's*, 449 U.S. at 162-163. But Texas has never attempted to characterize its 100% appropriation of funds earned on IOLTA accounts as a fee for its administration of those funds; rather, it justifies its appropriation by contending that IOLTA depositors lack any property rights in IOLTA interest. Nor have Petitioners sought to characterize IOLTA as a tax or a "users' fee" on users of the legal system. That clearly was not Petitioners' rationale in establishing the IOLTA program. If it were, it would be arbitrary indeed, because it falls haphazardly on those who place small sums in the hands of their lawyers, and not on others who place larger sums, or on those who make extensive use of the legal system yet find no need to put money into the custody of their lawyers.

In sum, the doctrine that "interest follows principal" is a universally accepted principle of property law throughout the United States, including within the State of Texas. As the Court recognized in *Webb's*, the principle is fully applicable regardless whether the owner of the property had a right to insist that interest be generated by his funds, regardless of the amount of interest at issue, and regardless

¹²(...continued)

The United States's reliance on trust law for the proposition that attorneys as trustees are under no duty to make productive use of trust assets (U.S. Br. at 14) similarly misses the mark. Trust law is clear that regardless whether a trustee is under any obligation to invest trust funds for a profit, if he actually does so any profits earned belong to the beneficiary. See 2 A. Scott, *The Law of Trusts* § 181 (3d ed. 1967). See generally, C. Rounds, *Social Investing, IOLTA and the Law of Trusts: The Settlor's Case Against the Political Use of Charitable and Client Funds*, 22 Loy. U. Chi. L.J. 163 (1990).

whether the owner had a "reasonable, investment-backed expectation" of receiving interest. That principle is controlling in this case. The interest actually generated by Respondents' trust funds is their property, for purposes of Takings Clause analysis, whether or not they would in fact have received interest on it in the absence of IOLTA.

C. Texas May Not Evade Takings Clause Review by Abrogating the Interest-Follows-Principal Rule for the IOLTA Program and in No Other Contexts

While Petitioners concede that Texas property law generally adheres to the rule that interest belongs to the owner of the property that generated it, they assert that Texas has the right to alter its property law as it sees fit. Petitioners note that the Supreme Court of Texas has declared, as a matter of Texas law, that interest generated by IOLTA accounts belongs to TEAJF, not to the owner of the funds that generated the interest. Pet. Br. at 9. Accordingly, Texas and its supporting *amici* argue, the Takings Clause is inapplicable to this case because none of Respondents' "private property" (as defined by state law) can be said to have been taken. See, e.g., *id.* at 21-23; Br. of Conference of Chief Justices at 29.

It is true that "[p]roperty interests . . . are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law." *Webb's*, 449 U.S. at 161 (quoting *Roth*, 408 U.S. at 577). However, *Webb's* went on to explain:

[A] State, by *ipse dixit*, may not transform private property into public property without compensation,

even for the limited duration of the deposit in court. This is the very kind of thing that the Taking Clause of the Fifth Amendment was meant to prevent. That Clause stands as a shield against the arbitrary use of governmental power.

Webb's, 449 U.S. at 164. See also, *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 439 (1982) ("the government does not have unlimited power to redefine property rights").

Accordingly, a state may not evade Takings Clause restrictions by simply declaring that property it covets is no longer privately owned. "Property" is an evolving concept, and states are empowered to modify from time to time "the bundle of rights" that are commonly characterized as property. *Lucas*, 505 U.S. at 1027-1028. But any such modifications must be consistent with "background principles of . . . property law" that remain in place following the modification. *Id.* at 1031. A state may not, as Texas seeks to do in connection with the IOLTA program, eliminate centuries-old property rights for one small class of individuals while continuing to recognize such rights for others (including the state itself) that are similarly situated. Any such state effort can fairly be categorized as an "*ipse dixit*" and thus does not diminish the Fifth Amendment claims of those objecting to the state's actions.

Webb's makes clear that such *ipse dixits* are suspect regardless whether a state acts retroactively, or prospectively only, in redefining property rights. Indeed, the Florida statute at issue in *Webb's* was a prospective statute: it applied only to interest generated *after* the statute had been adopted. The Court nonetheless branded as an "*ipse dixit*"

Florida's pronouncement that interest earned on privately owned court-registry funds was "public money," in light of background principles of property law to the contrary. *Webb's*, 449 U.S. at 163-164. Thus, it is no defense for Texas to assert that the IOLTA program was already in place at the time Respondents' funds were deposited in attorney trust accounts.

The Texas IOLTA Rules seek to decree that owners of funds placed into IOLTA accounts lack any state-law property rights in interest generated by those funds. No other category of Texas property owners is similarly disfavored. To the contrary, with the exception of the IOLTA program, Texas (along with every other state) has consistently adhered to the interest-follows-principal rule. *Sellers*, 483 S.W.2d at 243; *Lawson*, 220 S.W. at 272. The order declaring that IOLTA interest does not belong to the owners of the principal provided no explanation, other than a desire to facilitate TEAJF's compliance with federal banking laws.¹³ Under *Webb's*, such unprincipled efforts to transform private property into public property do not deprive objecting property owners of their rights to recourse under the Fifth Amendment.

¹³ The Supreme Court of Texas's July 1, 1985 order, which addressed ownership of IOLTA interest (*see* Pet. Br. at 9 n.9), provided that the court's 1984 order establishing the IOLTA program be amended by adding the following paragraph:

It is further ordered that the Texas Equal Access to Justice Foundation shall hold the entire beneficial interest in the interest generated by and paid to the Foundation by each trust account established pursuant to Article XI of the State Bar Rules so as to make such accounts eligible under 12 U.S.C. Section 1832(a)(2) for placement in NOW and Super NOW accounts.

Indeed, despite its current litigation posture, Texas in several recent cases has invoked the interest-follows-principal rule to win the right to collect interest under circumstances highly analogous to those faced by Respondents. The two cases, *Matter of Al Copeland Enterprises, Inc.*, 991 F.2d 233 (5th Cir. 1993), and *In re Megafoods Stores, Inc.*, 210 Bankr. 351 (B.A.P. 9th Cir. 1997), both involved efforts by the State of Texas to recover sales tax receipts (plus interest) collected by companies that filed Chapter 11 bankruptcy petitions. Under Texas law, the debtors were deemed to hold those receipts in trust for the State. TEX. TAX CODE ANN. § 111.016 (Vernon 1992). Accordingly, the debtors were ordered to turn the sales tax receipts over to Texas (pursuant to Texas trust law), rather than to hold the funds as part of the bankruptcy estate for the benefit of all unsecured creditors. *Copeland*, 991 F.2d at 235; *Megafoods*, 210 Bankr. at 356.

The next issue in both cases was, who was entitled to the interest earned on the trust funds while they were in the possession of the debtors? Texas conceded that, under its sales tax laws, it had no right to demand interest on the sales tax trust funds during the first 60 days that payment was delinquent; nor does federal bankruptcy law provide for payment of interest on allowed claims. The courts nonetheless agreed with Texas's argument that it was entitled, *as a matter of Texas trust law*, to recover the interest that in fact had been earned on the trust funds during the first 60-day period they were held by the debtors. *Copeland*, 991 F.2d at 236-37; *Megafoods*, 210 Bankr. at 358-59. As the Ninth Circuit Bankruptcy Appellate Panel explained:

The reason the State is entitled to the 4% rate of interest actually earned is because under state trust law, *earn-*

ings on property held in trust for another (i.e., the trust fund monies) are as much the property of the person for whom the trust monies are held as are the trust monies themselves.

Id. at 359 (emphasis in original).

The parallels between *Copeland* and *Megafoods* and this case are striking. Respondents are the beneficial owners of trust funds that are generating interest, as was Texas in *Copeland* and *Megafoods*. Neither Texas nor Respondents rested their claim on an asserted right to insist that the funds be deposited in an interest-generating account. Texas nonetheless persuaded two federal appellate panels that it was entitled, as a matter of Texas law, to recover the interest actually earned on its trust funds because "*earnings* on property held in trust for another . . . are as much the property of the person for whom the trust monies are held as are the trust monies themselves." *Megafoods*, 210 Bankr. at 359. Having successfully invoked state law to win the interest generated by *its* trust funds, Texas can articulate no principled basis for denying equal treatment for Respondents.

While conceding that Texas law adopts the interest-follows-principal rule in many cases, Petitioners insist that Texas has always recognized exceptions to the rule -- and that the IOLTA program simply creates one more exception. Pet. Br. 22-23.

The cases cited by Petitioners do not support their argument. *Price v. Austin Nat'l Bank*, 522 S.W.2d 725 (Tex. Civ. App.-Austin 1975, writ ref'd n.r.e.), merely recognized that the settlor of a trust is entitled to name the

beneficiaries of his trust, and that the power to do so includes the power to grant trust income to one person and to direct, upon that person's death, that the trust corpus be distributed to another. Granting such power to those creating trusts is not an exception to the interest-follows-principal rule; in such cases, the ultimate beneficiary of the trust corpus has not been granted an undivided interest in the corpus and thus simply is not in a position to invoke the interest-follows-principal rule.

The various community property cases cited by Petitioners are similarly unhelpful to their position. Texas community property law provides that when a man and a woman enter into a marriage contract, separate property brought into the marriage by one spouse continues to be the separate property of that spouse. *See, e.g., Arnold v. Leonard*, 273 S.W. 799 (Tex. 1925). But any interest or revenues derived from the spouse's separate property during the marriage are deemed community property. *Id.* at 803. Texas courts have never described this community property rule as an exception to the interest-follows-principal rule. Rather, it can best be understood as an effort to read an implied term into the marriage contract: one entering voluntarily into a marriage agrees to convey to his/her spouse one-half of all income derived from one's separate property. The interest-follows-principal rule has never been understood to prevent the owner of the principal from agreeing to convey a portion of his interest income to another.

Even if the cited cases were recognized as exceptions to the interest-follows-principal rule, they do not sufficiently alter "background principles of . . . property law" (*Lucas*, 505 U.S. at 1031) such that the exception created by the IOLTA program could be seen as anything other than an

ipse dixit. For example, the rule providing that income earned during a marriage is community property even when derived from the separate property of one spouse, hardly establishes "background principles of . . . property law" so as to justify creation of the IOLTA program; one cannot derive from that rule a principle whereby the state is permitted to declare that those who place funds in trust with their attorneys are required to relinquish to *the state* their *entire* rights to interest on those funds.

Texas cannot evade Takings Clause review of its IOLTA program by simply declaring that interest earned on IOLTA accounts is no longer to be deemed private property under Texas property law. As *Webb's* instructs, "the Takings Clause of the Fifth Amendment was meant to prevent" just such attempts to "transform private property into public property without compensation." 449 U.S. at 164.

D. Government Regulation of Interest and Interest Rates Do Not Negate a Fund Owner's Property Right in the Income It Produces

Petitioners and several of their supporting *amici* further miss the mark in this case with their fixation on pervasive government regulation of interest and interest rates. *See* Pet. Br. at 20; U.S. Br. at 9-19; ABA Br. at 12-14. As discussed in Part I.A., *supra*, it is true that governments have regulated the payment of interest for nearly as long as credit has existed. *See, e.g., Homer & Sylla* at 26. But any such regulation says nothing about the right of a depositor to the interest that a bank actually *pays*.

Indeed, this Court's cases have suggested that the government's power to regulate a commercial activity does

not permit the government to seize, without compensation, income generated by that activity. In *Webb's*, as discussed, the Court recognized the right of owners of a fund to receive the interest a bank paid for the use of the fund, even though the owners had no right to demand that the fund be deposited in an interest-bearing account, and even though the deposit was subject to a broad range of federal and state regulatory measures. *Webb's*, 449 U.S. at 162. Analogously, this Court has on numerous occasions affirmed rent control ordinances without doubting for a moment the right of the property owner to the rent actually paid. See, e.g., *Pennell v. City of San Jose*, 485 U.S. 1 (1988) (upholding rent control ordinance against a due process challenge); *Block v. Hirsh*, 256 U.S. 135 (1921) (upholding District of Columbia rent control law). Thus, this Court has plainly recognized that whether a property right exists is analytically distinct from whether the government may regulate the property.

Failing to grasp that distinction, Petitioners and their *amici* assert that Respondents are seeking compensation for interest income on the ground that they would have been able to earn it in the absence of government regulation of interest rates. See Pet. Br. at 20; U.S. Br. at 18-19, 22 n.19. They proceed as if Respondents have brought this suit against either (a) a bank regulator that refuses to allow Respondents' money to earn interest pursuant to a federal regulation; or (b) a bank that refuses to pay for the use of Respondents' money. Against such fictional challenges the United States triumphantly asserts that "the ability to obtain interest has never been understood as an entitlement or a right" (*id.* at 16) and that, given the long history of government regulation of the banking industry, "Respondents could [not] reasonably expect" that interest would be paid on their

funds. *Id.* at 19. If the United States means that the ability of a claimant to recover interest *actually paid* on his principal is not an entitlement or right, it is obviously wrong in view of *Webb's*. All that the United States has demonstrated is that a bank is not required to pay interest on a deposit unless it agrees to do so or the law compels it to do so -- a proposition Respondents do not challenge.

Respondents, of course, brought this case not against a bank, but against TEAJF, which has appropriated interest that a bank *has* paid for the use of Respondents' money. Respondents sued because the State of Texas forced the bank to pay TEAJF instead of Mr. Summers for the use of his money. The government's asserted power to prohibit the bank from paying any interest at all does not negate Mr. Summers's right to the interest the bank actually did pay.

At root, the arguments of Petitioners and their *amici* rest on a conception of interest as "government-created value" (U.S. Br. at 19-20) -- a property right that exists only at the sufferance of the government and only because it is created due to the workings of a government regulatory scheme. But the property rights at issue in this case are not dependent, as in *Board of Regents v. Roth*, on a government-created program that confers specific benefits on individuals. 408 U.S. at 577. Rather, the property rights arise because banks are ready, willing, and able to pay for the use of money owned by Respondents. While federal and state governments are empowered to regulate the circumstances under which interest is to be paid, *Webb's* dictates that any interest actually earned belongs to Respondents because "[t]he earnings of a fund are incidents of ownership of the fund itself." *Webb's*, 449 U.S. at 164.

II. VIRTUALLY ALL CLIENTS WOULD BENEFIT FINANCIALLY IF THEIR FUNDS WERE KEPT OUT OF THE IOLTA PROGRAM

For the reasons stated above, clients who place short-term and nominal deposits with lawyers have the same expectations as other depositors: they expect to receive any interest that is paid for the use of their money. Where interest is in fact paid, it is irrelevant for purposes of Takings Clause analysis whether the money could have earned interest if placed instead in an account for the benefit of the client.

However, the Court should affirm even if it determines, as urged by Petitioners, that the existence of a property right in IOLTA interest hinges on whether the Texas IOLTA program takes from clients income that they would have received were there no IOLTA program. Evidence in the record indicates that, virtually always, clients benefit if their trust funds are deposited into interest-bearing non-IOLTA accounts. J.A. 98-99. Because the IOLTA Rules prohibit such deposits in many instances, they impose a very real financial burden on clients. In addition, given the vague, obscure, and many-layered character of the Texas IOLTA Rules, it is inevitable that many lawyers put client money into IOLTA accounts out of uncertainty about what the Rules require.

A. The Record Indicates That Almost All Client Deposits Are Capable of Earning Interest for the Client, but in a Manner That the IOLTA Rules Foreclose

This case comes before the Court on review of a grant of summary judgment for Petitioners, which was reversed by the Fifth Circuit. In reviewing a lower court's decision on a motion for summary judgment, a court must view the facts in the light most favorable to the non-moving party. *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 456 (1992). That includes accepting factual assertions contained in the affidavits of the non-moving party's experts. *Id.*

In the district court, Respondents submitted an affidavit from Robert J. Randell, a New York attorney and an expert on escrow management and IOLTA practices. In his affidavit, Mr. Randell stated, "It is common knowledge that today, interest net of any fees can be earned on virtually *all* client funds through bank sub-accounting." J.A. at 98.¹⁴

¹⁴ In the context of attorney trust funds, bank sub-accounting is a practice whereby a lawyer opens under each client's name and tax identification number an interest-bearing account under the umbrella of, and linked electronically with, the lawyer's main trust account. J.A. 100. The interest accrues to each sub-account separately, thereby eliminating any requirement that the attorney himself allocate total interest earned among clients whose funds are in the account. *Id.* Sub-accounting services also include the IRS reporting tasks associated with each client's sub-account. *Id.* at 98-99. Mr. Randell's affidavit attaches exhibits from two banks (including one with a large Texas presence) that provide these services free of charge.

In addition, Mr. Randell explained why use of these bank sub-accounting services can be *less* expensive than use of an IOLTA account:

[A]n attorney has a fiduciary obligation to keep detailed accounting records of the history of each client's separate fund. With bank sub-accounting all the arithmetic is done by the depository. Running balances with accrued interest are maintained for each client's fund and are shown on monthly statements. Year-end IRS 1099's are provided as well, without charge. The attorney will spend less of his own time in general escrow administration using bank sub-accounts than if he maintains a pooled IOLTA account. With an IOLTA account, it is left to the attorney alone to compute what each client has in the account and to make sure the total of the individual client deposits coincides with the IOLTA total.

J.A. 98.

Notwithstanding the practical availability of these procedures, their use is prohibited by the rules governing IOLTA accounts in many instances. The IOLTA Rules direct attorneys to consider whether a non-IOLTA account could generate "net interest" for the client, *not* whether the client would be better off if his/her funds were placed in a non-IOLTA account rather than in an IOLTA account. See IOLTA Rule 6. As Mr. Randell stated, the administrative costs of maintaining a non-IOLTA account are no higher (and, in some instances, may be lower) than the administrative costs of maintaining an IOLTA account. J.A. 98. Yet, whenever (as will often be true) a client's per capita share of the total administrative and overhead costs of maintaining

an interest-bearing account would be greater than his share of interest generated from that account, IOLTA Rule 6 requires that such funds be placed into an IOLTA account. The net result, from the client's perspective, is that interest generated by his funds is paid to TEAJF rather than being used to defray the costs of maintaining the trust account.

Moreover, there is considerable question regarding whether IOLTA Rule 6 even permits attorneys to employ sub-accounting when determining whether client funds may be kept out of the IOLTA program. Rule 6 provides that the lawyer must consider whether each client's deposit can earn interest net of enumerated costs "*without regard to funds of other clients which may be held by the attorney.*" (Emphasis added.) On its face, this restriction appears to prohibit pooling client funds in non-IOLTA accounts. Further, in literature distributed to Texas attorneys throughout much of the Texas IOLTA program's existence, TEAJF officials have repeatedly interpreted Rule 6 as requiring the maintenance of a separate account for each client whose funds the attorney desired to keep outside the IOLTA program. See, e.g., S. Peterson and W.F. Newton, *Trust Accounts and the New Comprehensive Interest on Lawyers' Trust Accounts Rule*, 52 Tex. Bar J. 590 (May 1989).¹⁵

¹⁵ As noted above, *supra* at 5 n.1, Petitioners have apparently abandoned that position in this litigation. In the Fifth Circuit, Petitioners stated that they now interpret Rule 6 as permitting sub-accounting in connection with non-IOLTA trust accounts, provided that use of such accounts is otherwise permissible under the Rule. *Id.* Given the quoted language from Rule 6 and the minimal likelihood that Texas lawyers are familiar with Petitioners' litigation position, however, at the very least they will be uncertain about whether they can pool client funds in non-IOLTA accounts in order to defray account maintenance costs. Further, as the Court (continued...)

The evidence submitted by Respondents indicates that virtually all clients whose funds are deposited into attorney trust funds would benefit financially if those funds were placed in non-IOLTA interest-bearing accounts, but that Texas requires attorneys to deposit the funds of many such individuals into IOLTA accounts. Accordingly, even if the Court accepts Petitioners' contention that a Takings Clause cause of action requires a showing that Respondents could have benefitted financially in the absence of the IOLTA program, the Fifth Circuit's decision reversing the grant of summary judgment should be affirmed.

B. The Texas IOLTA Rules Are Complex and Vague and Thus Do Not Effectively Protect Clients' Rights To Interest Generated by Their Funds

Any lawyer seeking to serve his client by using trust funds to generate interest income for the client faces a daunting task. The Texas IOLTA rules are complex, multi-layered, and highly confusing; they do not give reasonable guidance to lawyers who must decide what to do with client funds. At the same time, TEAJF and Texas State Bar officials have been urging attorneys for years to demonstrate their commitment to "equal access to justice" by maximizing IOLTA participation. See, e.g., C. Smith, *IOLTA: A No Lose Program*, 48 TEX. BAR J. 752 (July 1985). And the rules provide lawyers with immunity so long as they act in good faith. IOLTA Rule 23, J.A. 121. The net result is to

¹⁵(...continued)

noted last term, a party's submissions regarding statutory scope that are contrary to the text of the statute are not especially meaningful. *Reno v. ACLU*, 117 S. Ct. 2329, 2349 (1997).

systematically tilt the scales in favor of placing client funds into IOLTA accounts rather than investing them for the benefit of the client, and to appropriate income to the State which could practicably accrue to the benefit of the client.

Texas maintains three sets of vague and somewhat-contradictory rules governing client trust funds. Texas Rule of Professional Conduct 1.14(a), which governs the safe-keeping of client property, states in relevant part that "[s]uch funds shall be kept in a separate account, designated as a 'trust' or 'escrow' account. . . ." However, the rule does not specify into what type of account client funds should be deposited, and it is silent regarding whether the attorney should seek to earn interest on the account.

The maintenance of attorney trust accounts is also addressed by the rules establishing the Texas IOLTA program: Article XI of the State Bar Rules. Article XI, § 5(A) provides that attorneys are to maintain an IOLTA account into which they are to deposit "client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time." It further provides that the IOLTA account is to be an "interest-bearing demand account at a financial institution," but does not define the term "demand account." Article XI goes on to provide that nothing contained therein should be construed to prohibit attorneys from depositing client funds into non-IOLTA "interest-bearing accounts or other investments permitted by the Texas Code of Professional Responsibility," with interest payable to the client. Art. XI, § 5(B). Section 5(B) is silent regarding what types of "interest-bearing accounts" and what "other investments" are permissible.

Yet a third set of rules governing client trust funds is the IOLTA Rules. J.A. 108-125. IOLTA Rule 4 provides that IOLTA funds (i.e., "client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time") must be deposited in an "interest-bearing insured depository account at a financial institution." J.A. 111. Rule 7 provides that this IOLTA account must be one "from which withdrawals or transfers may be made on demand" and must be established in a federally or state-insured "bank, credit union or savings and loan association." As is true of the other two sets of rules, the IOLTA Rules provide no guidance regarding the types of accounts into which non-IOLTA trust funds are to be deposited.

For guidance regarding whether or not client funds are "nominal" or "short[-term]," and thus must be deposited into an IOLTA account, attorneys must look to Rule 6. J.A. 113-14. Rule 6 requires client funds to be placed in IOLTA accounts:

[I]f . . . , considered without regard to funds of other clients which may be held by the attorney, . . . the interest which might be earned on such funds is not likely to be sufficient to offset the costs of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client. Also to be considered are the nature of the proceeding or transaction involved and the likelihood of delay in the need for such funds in such proceeding or transaction.

The Rules provide no further guidance regarding how attorneys are to undertake the complex financial calculations outlined in Rule 6.¹⁶

¹⁶ Guidance documents issued by TEAJF are similarly vague, but TEAJF officials have used the occasion to provide a none-too-subtle message that non-IOLTA accounts entail quite high administrative costs and thus should be used sparingly. For example, excerpts from Peterson and Newton, *supra* (reprinted as a four-page TEAJF guidance document for lawyers, entitled "The Mechanics of IOLTA"), warns that "all costs associated with" a non-IOLTA account "will be either directly or indirectly passed on to the client, so the client's separate [non-IOLTA] account must earn enough to justify its existence." Peterson and Newton, *supra*, at 591. The document states that "cost factors" to consider in determining whether client funds can generate net interest "include":

Internal costs:

1. the expense of the attorney's or law firm's staff time in establishing the separate account
2. the preparation and filing of tax forms relating to the account to the IRS (e.g. IRS 1099 forms)
3. the bookkeeping and accounting expenses for tracking the account
4. the monthly reconciliation of the account for the client
5. closing the account at the bank and remitting the funds to the client

External costs:

1. the minimum balance requirement at the bank at which the account is placed
2. the service charges, if any, assessed against the account by the bank
3. other additional fees that the bank may have for investment policies.

Id.

Compounding the difficulty of the task required of attorneys by Rule 6 is the failure of the any of the three sets of rules enumerated above to specify the types of interest-bearing accounts into which non-IOLTA trust funds may be placed. Current interest rates on NOW accounts of around 1 1/2% per annum are far lower than rates available on savings accounts and money market accounts. Thus, the ability of client funds to generate "net interest" varies widely depending on the type of account into which they are deposited, yet Texas rules provide virtually no guidance regarding the type of account to be used for non-IOLTA funds.¹⁷

¹⁷ Some of Petitioners' supporting *amici* suggest that the IOLTA Rules require that attorneys place *any* attorney trust funds, whether IOLTA or non-IOLTA, into NOW accounts. *See, e.g.*, U.S. Brief at 3; ABA Brief at 7, 8 n.9. Petitioners' brief hints that they may support that contention. *See, e.g.*, Pet. Brief at 5. The apparent purpose of this contention is to suggest that those clients who do not qualify for NOW accounts (e.g. for-profit corporations) could never earn interest for themselves on funds they deposit with their attorneys, no matter how large those deposits happen to be.

However, nowhere do either Article XI or the IOLTA Rules state that *any* attorney trust funds must be deposited in NOW accounts. Dealing only with IOLTA funds, Article XI, §5 requires only that they be placed in a "demand account," and there is no parallel requirement for client funds deposited in non-IOLTA accounts. While the term "demand account" is not defined in either Article XI or the IOLTA Rules, Respondents are unaware of *any* definition of "demand account" that would include NOW accounts but would exclude savings accounts on which corporations can earn interest. Under federal banking regulations, a "demand deposit" (on which banks are prohibited from paying interest, *see* 12 U.S.C. § 371(a)), includes checking accounts, but does *not* include savings accounts *or* NOW accounts. 12 C.F.R. §§ 204.2(b)(1), (b)(3)(i), and (b)(3)(ii).

Article XI, § 5 uses the term "demand account" in its more commonly understood sense: an account that permits depositors near-immediate access
(continued...)

If an attorney has many clients for whom he holds money in trust, it may occur to him to pool that money in one interest-bearing account and sub-account each client's interest to save costs. While such a course appears to be consistent with the Texas Rules of Professional Conduct, as discussed above (*see supra* at 40-41) it is inconsistent with the literal language of IOLTA Rule 6. Petitioners' apparent abandonment of Rule 6's literal language during the course of this litigation does not ameliorate the impact of the rule on lawyers faced with choices about the disposition of client funds. There is every reason to expect that lawyers will continue to believe, with Respondent Mazzone, that the relevant issue under IOLTA Rule 6 is whether a client's funds can generate net interest when a separate account is opened for those funds.¹⁸

¹⁷(...continued)

to their funds. IOLTA Rule 7 requires IOLTA funds to be placed in an account "from which withdrawals or transfers may be made on demand (subject only to any notice period which the financial institution is required to reserve by law or regulation) . . .," thus indicating that payment on "demand" refers to ease of access to funds, not to check-writing privileges. Indeed, both IOLTA Rule 8 and Article XI, §6 make clear that even time-deposits, such as certificates of deposit, may be used for IOLTA accounts under certain circumstances. And IOLTA administrators, both in Texas and elsewhere, have actively encouraged attorneys to place their IOLTA funds in accounts that pay higher rates of interest than do NOW accounts.

Accordingly, attorneys are permitted to deposit client trust funds in investment vehicles other than NOW accounts. The virtually exclusive focus of Petitioners and their *amici* on NOW accounts is therefore not justified. But their misreading of the relevant rules well illustrates the confusing nature of those rules.

¹⁸ *See* Affidavit of Respondent Mazzone, J.A. 83. Mr. Mazzone's statement that funds entrusted to him by clients often were unable to generate
(continued...)

In sum, the regulations surrounding the administration of the IOLTA program create great uncertainty about the obligations of lawyers who are ultimately responsible for its implementation. Little guidance is provided regarding how to determine whether trust funds are likely to generate net interest, and the kinds of bank accounts (or other investments) lawyers should or must consider. In the face of such uncertainty and of TEAJF's insistence that the administrative and overhead costs of operating non-IOLTA accounts are quite high, the natural instinct of any lawyer confused (quite understandably) about his obligations is to deposit virtually all trust funds into an IOLTA account. The inevitable effect of the maze of vague and complex Texas IOLTA rules, then, is to steer into IOLTA accounts substantial amounts of attorney trust funds that could have generated net interest for their owners.

III. THE COMPUTER REVOLUTION CONFIRMS THAT THE EXISTENCE OF A PROPERTY INTEREST SHOULD NOT TURN ON THE AVAILABILITY AND COST OF FINANCIAL ACCOUNTING SERVICES.

Petitioners go to great pains to show that the organized bar and the banking world could not conceive in the early 1980's how short-term and nominal client deposits could ever earn *any* interest. See Pet. Brief at 4-8. The advent of the NOW account provided a practical way to collect interest on qualified checking account deposits. Sub-

¹⁸(...continued)

net interest when deposited in a separate account (¶ 4) was written in 1994, before Petitioners announced in the Fifth Circuit that they had reinterpreted IOLTA Rule 6.

accounting, of course, represented a further advance in banking practices and computer technology, albeit only a modest one. See J.A. at 100.

Beyond these relatively narrow developments, revolutionary advancements in computers and information technology also bear strongly on the issue before the Court. Since the birth of the IOLTA concept in the 1980's, the cost of performing complex calculations has plummeted exponentially, and the speed with which we are able to do so has moved as fast in the opposite direction. The utilization of computer equipment to perform the kinds of functions that Petitioners make the centerpiece of their brief has gone from uncommon to universal. In 1984, the year Texas first promulgated its IOLTA program, IBM compatible computers were available with 256 kilobytes of memory, 10 megabytes of internal storage, and 8 MHz of processor speed. "Buyer Guide," *PC Week*, Feb. 28, 1984, 34-35. For a basic 1984 PC, the price was around \$2,700, and PCs with added power and speed cost considerably more. *Id.* For about half that price today, one can purchase a computer with 60 times the memory and nearly 350 times the internal storage, working 25 times faster than the most advanced PCs available in 1984 -- with a long list of features enhancing its ease and effectiveness of use. See THE COMPUSA PC. THE CHOICE IS YOURS, *The Wall Street Journal* (Sept. 25, 1997) A21 (advertisement).

These advances in technology bear out Moore's Law (named for Gordon Moore, cofounder of Intel), that the memory capacity of computer chips doubles every 18 months. This has been the experience since 1965, and Microsoft founder Bill Gates predicts that Moore's Law will hold for another twenty years or so. Bill Gates, *The Road*

Ahead, at 35-36 (1996). "If it does, a computation that now takes a day will be more than 10,000 times faster and thus take fewer than ten seconds." *Id.* at 36.

As Federal Reserve Chairman Alan Greenspan recently acknowledged, relentless advancements in computer technology have "lowered the costs, reduced the risks, and broadened the scope of financial services," resulting in increased competition in the financial services industry. *Remarks by Alan Greenspan at the Annual Convention of the American Bankers Association*, (visited Oct. 7, 1997) <<http://www.bog.frb.fed.us/BOARDDOCS/SPEECHES/19971005.htm>> (given on Oct. 5, 1997 at Boston, Mass.). Indeed, technology and competition have combined to make the software necessary to perform many complex banking tasks so inexpensive that much of it is available for free. See, e.g., "Chevy Chase Offers Direct Touch Banking, The Washington Post (Sept. 25, 1997) A15 (advertisement). See generally, Douglas Goldstein and Joyce Flory, *The Online Business Guide to Financial Services*, 110-123 (1997).

All of these developments serve not merely to alter, but to revolutionize overnight, the reasonable expectations of parties in countless specific subject areas. Yet, the Texas IOLTA program has failed to keep pace with these changes. The IOLTA Rules were promulgated at a time when the abilities and costs of banks and attorneys to perform accounting functions seemed to some predictable and fixed, and the only functional way a lawyer could keep a client's funds readily available was through a checking account

(which could not earn interest).¹⁹ To continue an IOLTA program at a time when technological advances have made it possible for clients virtually always to benefit from the use of their trust funds (J.A. 98) makes little sense. Continuation of the program and the active promotion of its use conveys the false impression to lawyers that there is no way for their clients to benefit from the use of their trust funds.

Surely the existence of a constitutional property interest cannot depend on the state of banking services in the mid-1980's when IOLTA was initiated. Nor should it rest on moment-by-moment monitoring of the computer revolution to determine the precise moment when technological advances permit attorneys to generate net interest on nominal and/or short-term trust deposits. A far more prudent course is to recognize, as this Court previously recognized in *Webb's*, that "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." 449 U.S. at 164.

¹⁹ In fact, even before the Texas IOLTA program was implemented, critics (including at least one member of the State Bar of Texas's "Client Protection Committee" that investigated the feasibility of an IOLTA program) strongly suggested that technological advances were undermining "the theoretical underpinnings of the plan -- the inability or impracticality of allocating small amounts of interest to the individual client." See T. Baker and R. Wood, "Taking" A Constitutional Look at the State Bar of Texas Proposal to Collect Interest on Attorney Client Trust Accounts, 14 Tex. Tech L. Rev. 327, 334 & n.38 (1983).

CONCLUSION

Respondents respectfully request that the judgment of the U.S. Court of Appeals for the Fifth Circuit be affirmed.

Respectfully submitted,

MICHAEL J. MAZZONE
9 Greenway Plaza
Suite 2300
Houston, TX 77046
(713) 940-6001
Pro Se

DANIEL J. POPEO
RICHARD A. SAMP
(Counsel of Record)
WASHINGTON LEGAL FOUNDATION
2009 Massachusetts Ave, NW
Washington, DC 20036
(202) 588-0302

DONALD B. AYER
THOMAS FISHER
JONES, DAY, REAVIS & POGUE
1450 G St., NW
Washington, DC 20005-2088
(202) 879-3939

*Attorneys for Petitioners WLF
and William R. Summers*

Date: October 10, 1997

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In The
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October Term, 1997

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ,
HON. NATHAN L. HECHT, HON. JOHN CORNYN, HON.
CRAIG T. ENOCH, HON. ROSE SPECTOR, HON. PRISCILLA
OWEN, HON. JAMES A. BAKER, HON. GREG ABBOTT, In
Their Official Capacities As Justices of the Texas Supreme
Court; TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION;
and W. FRANK NEWTON, In His Official Capacity As
Chairman Of The Texas Equal Access To Justice Foundation,

v.

Petitioners,

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
SUMMERS, and MICHAEL J. MAZZONE,

Respondents.

On Writ Of Certiorari To The United States Court
Of Appeals For The Fifth Circuit

REPLY BRIEF FOR PETITIONERS

NANCY TREASE
Office of the Attorney
General of Texas
P.O. Box 12548,
Capitol Station
Austin, TX 78711
(512) 475-4075

Attorneys for Petitioners
Hon. Thomas R. Phillips,
Hon. Raul A. Gonzalez,
Hon. Nathan L. Hecht, Hon.
John Cornyn, Hon. Craig T.
Enoch, Hon. Rose Spector,
Hon. Priscilla Owen, Hon.
James A. Baker, Hon. Greg
Abbott, In Their Official
Capacities as Justices of the
Texas Supreme Court

November 10, 1997

DARRELL E. JORDAN*
BRITTAN L. BUCHANAN
DAVID J. SCHENCK
BETH W. BIVANS
HUGHES & LUCE, L.L.P.
1717 Main Street,
Suite 2800
Dallas, TX 75201
(214) 939-5500

Attorneys for Petitioners
Texas Equal Access to
Justice Foundation, And
W. Frank Newton, In His
Official Capacity As
Chairman Of The Texas
Equal Access To Justice
Foundation

**Counsel of Record*

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REPLY BRIEF FOR PETITIONERS

The Texas IOLTA program funds the Texas Equal Access to Justice Foundation to enhance the provision of civil legal services to the state's indigent population. The only funds eligible for deposit in an IOLTA account are those that are incapable of earning net interest for the client. If there is any legally and economically permissible way to earn net interest for the client, Texas lawyers are obligated to do so. Lawyers are free to use any potential pooling or subaccounting services that are actually available to earn net interest for the client. If the lawyer reasonably believes that the funds are not capable of generating net interest, IOLTA requires the funds to be deposited into an aggregated IOLTA account with the principal available for return to the client on demand. If there is any doubt about where funds should be placed, the State Bar of Texas widely advertises a toll-free phone number to answer any IOLTA-related question a lawyer might have. *See Tex. B. J.*, Nov. 1997, at 1079. As was true before changes in federal banking law made IOLTA possible, the decision whether to advance funds to a lawyer is left to the client and lawyer, and in some cases, a third party who might demand some form of escrow as part of a transaction.

Neither the requirement that Texas lawyers maintain IOLTA accounts nor the designation of the Texas Equal Access to Justice Foundation ("TEAJF") as the recipient of the IOLTA funds infringes the property interest of any Respondent. Rather, this case presents the narrow question of whether interest earned on IOLTA accounts is "property" belonging to those clients who have surrendered to their lawyers funds incapable of generating net interest on their own. Fifty states have adopted IOLTA programs on the premise that a client is not denied any property where net interest income is only possible as a

result of the efficiencies of aggregating funds from multiple clients in an IOLTA account. Two federal circuits have agreed. Only the Fifth Circuit panel *a quo* has found IOLTA proceeds to be "property" of clients whose trust deposits could not earn net interest outside of IOLTA.

But to read the brief of Respondents, one would conclude the issue is whether the federal courts should scrutinize the Texas IOLTA program for perceived defects in the manner in which Texas established and operates the IOLTA program. That Respondents' objections do not rise to a constitutional dimension is apparent from the complete absence of any effort to show how any of these three Respondents have suffered the slightest injury as a result of the Texas IOLTA program. And that absence of injury is the direct result of the record made in the district court where Respondents conceded they would not be one penny richer if IOLTA did not exist.¹ Because Respondents have not shown any cognizable property right and have also failed to establish that the Texas IOLTA program injured them in any identifiable way, the judgment below should be reversed, and the district

¹ Respondents' own recognition that the record they made in the district court is of no help to them can be seen from the fact they cite the affidavit of the plaintiff Summers only on page 8 of their brief, they cite that of plaintiff Mazzone on the same page and on page 47, n.18 for a point unrelated to their claim of direct injury to Respondents' property, and they never cite to any record evidence to support the claim of the Washington Legal Foundation. In a similar vein, they refer to the opinion of the court of appeals only in their description of the proceedings below (Resp. Br. 8-9) and never rely on any of the arguments made by that Court in order to defend the judgment below. Given Respondents' apparent abandonment of the Fifth Circuit's rationale, Petitioners see no reason to respond further to most of what the Fifth Circuit said, although this reply does respond to two pithy phrases that cannot be defended. *See infra* 10 & 15 n.9.

court's decision, entering judgment dismissing the complaint, should be reinstated.

NO PROPERTY RIGHT OF ANY RESPONDENT HAS BEEN VIOLATED.

While Respondents strain to fit their tenuous First Amendment objections into the context of a takings claim, to have a legal claim of any kind, Respondents must show they have been deprived of some property belonging to them. Their so-called First Amendment claim, based on the *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209 (1977) and *Communications Workers of Am. v. Beck*, 487 U.S. 735 (1988) line of cases, which is not part of the question presented under this Court's Order of June 27, 1997, depends on some use of their property (union dues in those cases; allegedly lost interest here) in a manner that offends the beliefs of the property owner. Thus, the first hurdle Respondents must overcome is to show, on this record, that they have been deprived of some recognized property right that belongs to them. This they have utterly failed to do.

Not even a plausible argument exists for two of the three Plaintiff-Respondents: Washington Legal Foundation and attorney Michael Mazzone. The former is a non-profit corporation located in Washington D.C., with no Texas offices or bank accounts. WLF does not even pretend to have an affected property interest of its own. There is no showing in this record that any of its other members or supporters have lost any property, even to the degree claimed by Mazzone and Summers. Hence, WLF simply has no claim arising from the operation of the IOLTA program. Mazzone likewise cannot claim a property right in proceeds generated by IOLTA. There is no dispute that all of the client's principal, whether in an IOLTA or other trust account, must be held for the client and surrendered on demand, and Texas law, undisputed

here, forbids a lawyer from making any profit from trust funds given to him by a client. Thus, WLF's and Mazzone's claims were both properly dismissed; neither had a claim on the merits or any justiciable injury stemming from the operation of the Texas IOLTA program. See *Lewis v. Casey*, 116 S. Ct. 2174 (1996).

That leaves only the client Summers. But he fares no better. One of Summers' problems is the utter lack of evidence he actually lost money that would have been paid to him but for the Texas IOLTA program. He attempts to sidestep this problem in two ways: first, he argues that the Court need only examine whether interest will be earned on his funds, which he claims would belong to him. He further claims that the Court, in making this examination, should disregard the inevitable costs associated with earning that interest in determining whether his property rights have been violated. This first argument is based on the fallacy that a person's prospective interest in property can be determined by examining only the positive gains and disregarding the costs. Second, he argues there are ways in which clients generally are able, with the aid of computers and friendly bankers, to earn net interest and that IOLTA interferes with their doing so. This second argument is precluded by, among other things, the absence of any factual basis in this record to indicate Respondent Summers (or for that matter any other Texas client) could have earned any net amount on any IOLTA deposit.

A. In Determining Whether A Property Interest Exists, The Court Must Consider The Cost of Acquiring the Property.

The bulk of Respondents' brief (pp. 12-35) is devoted to an attempt to persuade the Court that a person may suffer a constitutional deprivation of "property," even if the cost of acquiring that property is greater than its resulting value. It makes no difference, according to

Respondents, that Summers could not have realized this interest because the costs, outside of the IOLTA program, would have exceeded that income. Respondents' argument fails as a matter of both economics and law. At bottom, even under the broadest understanding of the term "property," that phrase is understood to relate to "a thing of value." E.g., Tex. Tax Code Ann. § 1.04(5) (Vernon 1992).

1. Respondents' argument fails to account for any costs that would be incurred to generate the interest Summers claims.

Analysis of the existence *vel non* of a "property" right cannot turn on whether there is a benefit without regard to the attendant costs. Rather, "the expectations protected by the Constitution are based on objective rules and customs that can be understood as reasonable by all parties involved." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1035 (1992) (Kennedy, J., concurring) (emphasis added). No reasonable person considers a transaction without regard to the costs associated with it. Investment-backed expectations are based not only on the potential for prospective gain but also on the economic reality that there is, in fact, some cost in making an investment.

The first premise of IOLTA is that if a client's funds are capable of generating a net benefit to the client the funds do not belong in an IOLTA account. It is only when the funds cannot be invested to benefit the client that IOLTA steps in and asks whether any other benefit can be realized. Even then, contrary to Respondents' assertion (Resp. Br. at 35), the funds may be placed in a non-IOLTA account if a lending institution offering IOLTA accounts is not available. Although most Texas banks accept IOLTA

accounts for a variety of reasons,² they are not obligated to do so.

The simple economic reality is that money placed in a non-IOLTA account will yield interest income only if the associated costs are less than the interest earned; no bank would permit its depositors to take the interest and principal out of an account without a reckoning of the expenses. Even if IOLTA were repealed, banks still would receive *all* of the net benefit where costs exceed the interest, just as banks did before the advent of NOW accounts, and just as banks would continue to do for corporate deposits.³ Unless Respondents believe that the Government's decision to forbid the payment of interest on demand accounts (prior to NOW), or the decision to exclude for-profit corporations from using NOW accounts today constitute "takings," it is difficult to understand where Respondents' argument could lead them.

Nonetheless, Summers, undaunted by economic reality, contends that, in determining whether he has lost any property rights, the Court should disregard all of the costs associated with earning interest on his deposit and ask only whether there were earnings that might have been paid to Summers. Summers apparently recognizes that, prior to NOW accounts, and even today in the absence of a bank which offers low-cost sub-accounting, he and other clients would receive nothing, yet he insists,

² For example, banks are subject to a series of federal regulations – not challenged here – that encourage participation in programs like IOLTA. See 12 U.S.C. § 2901, *et seq.* (1989); 12 C.F.R. § 228 (1997). Moreover, banks use IOLTA to attract other business from lawyers. And, even with the interest paid in IOLTA accounts, banks still realize a net profit from these deposits.

³ Corporations are prohibited under federal banking law from maintaining NOW accounts. Pet. Br. at 5.

because someone else (IOLTA) actually was paid the interest earned on his share of the principal amount in the IOLTA account, he has been deprived of his property in violation of the Constitution (Resp. Br. at 33). That argument simply makes no sense.⁴ Indeed, if it were adopted, every depositor could sue their bank if the bank put its profits to a use to which the depositor objected.

Property is a meaningful right only if it can be exercised. Here, Summers asks the Court to disregard the fact that he would never receive a penny, but never answers the question of what "property" has been taken from him as a result of IOLTA. While IOLTA did not create these external costs, somehow, in Summers' constitutional calculus, he feels entitled to disregard them.

His answer seems to be that here the bank is actually paying out "interest," whereas prior to IOLTA it was not paid out at all (Resp. Br. at 35). Aside from the complete lack of authority for this proposition, his concept of payment focuses the inquiry much too narrowly. Although what the bank earned on a non-IOLTA account (either prior to NOW accounts or in a situation in which no net earnings would accrue to the depositor) would not be paid out with a label "interest," the benefits would inure to the bank and its stockholders. The "interest" would benefit someone other than Mr. Summers, and yet he makes no claim that there would be a deprivation of his property or that he would have any right to the money

⁴ Respondents' brief never addresses the question, if Mr. Summers were "entitled" to the gross interest earned on his deposit, who besides Mr. Summers would pay the associated costs? Indeed, Respondents' own resort to the Austrian understanding of "interest" in the nineteenth century confirms that "lender's" concern in recent centuries has been with the ability to derive "permanent net income." Resp. Br. at 16 (quoting Eugene von Bohm-Bawerk, *Capital and Interest* (Huncke & Sennhols trans. ed., 1959)).

under the common law of property based on the proposition that interest always follows principal. Thus, as an economic concept of property, Summers' position has no basis in objective rules or customs that could be perceived as reasonable.

2. Summers has shown no legal basis for his expectation to own interest without regard to costs.

The law does not help Summers either. To be sure, there is little law on this issue, almost certainly because it is difficult to imagine the issue arising in a typical takings case. Nonetheless, what law there is supports Petitioners, not Respondents.

For example, in *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980) the Court accepted the right of the State to impose approximately \$10,000 in administrative costs for holding the principal amount for the benefit of the creditors, but held that the interest earned *after* those expenses could not be kept by the State. Under Respondents' theory of interest following principal, with all costs disregarded, the State in *Webb's* could not have kept any of the money, even to offset legitimate expenses that it incurred. The creditors in *Webb's* were not awarded that \$10,000 because the court recognized the cost of earning the interest.

Nonetheless, Respondent Summers' claimed property right hinges on *Webb's* and the assumption that it creates a property right for anyone who has a claim to principal where interest is paid, regardless of whether the person could have earned the interest himself or had any expectation to interest in excess of costs. Of course, *Webb's* does not state any such rule and no other authority supports the notion that Respondent Summers has any reasonable expectation to IOLTA interest.

The one Texas case relied upon by the Fifth Circuit panel, *Sellers v. Harris County*, 483 S.W.2d 242 (1972), is

equally clear in its holding that property rights do not exist in isolation from associated costs. The Texas Supreme Court was justifiably outraged by a statute that took \$6,000 per month in interest on interpleaded insurance proceeds, and held that the statute's operation constituted a "taking" of the claimants' property. In its specific holding, however, the Texas Supreme Court made a critical distinction, stating that "[b]y depriving the owner of a sum *not reasonably related to the value of the county's services in safeguarding and investing the principal*, the statute offends Article 1, Section 19 of the Texas Constitution as well as the Fourteenth Amendment of the United States Constitution." *Id.* at 244 (emphasis added). Notably, the court did not suggest, as Respondents must argue here, the claimants would own the interest even if they could never reasonably expect to receive any net interest. Nor did the court hold, as a matter of property law, that all of the interest earned in the commingled general accounts belonged to each potential claimant, even if the claimant's funds could not have earned net interest on its own.⁵

The Texas IOLTA program is fundamentally different from the interpleader statutes at issue in *Webb's* and *Sellers*. For one thing, the only funds that qualify for IOLTA treatment are those that could not earn net interest (defined as real income after deducting costs of "safeguarding and investing the principal") on their own. IOLTA reduces administrative and accounting costs in

⁵ Moreover, even if one generously assumed (as Respondents claim) that *Sellers* adopted a universal rule that "interest follows principal," that rule is hardly so ingrained that it could not be modified by the same court. The Texas Supreme Court's judgment that IOLTA's application to deposits that could not earn net interest is not only entitled to deference, it is also consistent with the expectations of Texas clients. See Brief of Conference of Chief Justices, at 5.

cases where net interest could not be earned for individual clients. The funds in *Webb's* and *Sellers* clearly could (and did) earn net interest, and it would have been a violation of IOLTA standards if an attorney ever had placed such funds in an IOLTA account.

In short, economic and banking realities are key to IOLTA as the same Texas Supreme Court that decided *Sellers* concluded in enacting it. Contrary to the views of the Fifth Circuit panel, Texas did not rely on "alchemy" (Pet. App. 7a) to produce net income from IOLTA, but rather on "efficiency" or "economies of scale" resulting from the pooling of accounts and elimination of the need to pay the costs of attributing interest to each client in the pool.

Another crucial difference between *Webb's*, *Sellers*, and this case is obvious when one examines the underlying trust obligations. In both *Webb's* and *Sellers*, state agents (court clerks) were acting as fiduciaries for funds owned by private litigants. See, e.g., *Sellers*, 483 S.W.2d at 243 ("these funds . . . are only held in trust for the litigant"). At the same time, however, the State was taking net interest earned on those funds and appropriating it to its own uses. This would be considered a breach of fiduciary duty and of legitimate expectations.

In this situation, however, the trust relationship runs between attorney and client. IOLTA requires only that an attorney substitute one type of non-interest bearing account for another, when interest cannot productively be earned for the client. An attorney who follows IOLTA rules violates no fiduciary obligation recognized by *Webb's* or *Sellers*, and infringes no legitimate client rights or expectations.

Texas law, the primary source for any historical expectation Respondent Summers might have to ownership over IOLTA proceeds, also does little to advance his claim. Contrary to the approach taken by the Fifth Circuit panel, the inquiry into Texas law does not begin and end

with *Sellers*. The historical right to collect interest in Texas is, in the words of the State's highest criminal court, "a creature of statute, not an inherent right." *Juhan v. State*, 216 S.W. 873, 874 (Tex. Crim. App. 1918). It exists as a result of its recognition by law or by an agreement between the parties. Texas law, including the Texas Constitution, has long regulated agreements that call for payment of interest. E.g., Forrest M. Smith, *The Regulation of Interest; Practice and Procedure*, 10 St. Mary's L.J. 825, 829-33 (1979); TEX. CONST. art. XVI, § 11; see also *Texas Land & Mortg. Co. v. Mullican*, 132 F.2d 241, 242 (5th Cir. 1943) (calling Texas' regulation of interest "strict"). Moreover, in looking to Texas law deference should be made to the administrative orders of the Texas Supreme Court regarding the Texas IOLTA Program, as well as the IOLTA rules themselves, as a source of Texas law dealing with rights in the context of client trust accounts. (Cert. Pet. App. at 56a; Pet. Brief at 9).

Respondents, however, insist they have discovered a universal common-law rule of Texas property law that was somehow violated by the Texas Supreme Court when it implemented IOLTA. The truth of the matter is that Texas law recognizes a general rule that interest is permitted – provided the rate is not usurious – if it is "allowed by law or fixed by the parties." *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 552 (Tex. 1985); see also *Smiley v. Citibank*, 116 S. Ct. 1730, 1735 (1996) (employing identical definition). Interest thus does not "follow principal" invariably under Texas law, as the rules regarding income-only trusts and community property demonstrate.⁶ The expectations a Texas client might

⁶ Respondents' efforts to explain away these rules are unavailing. Texas community property rules provide that all of the spouse's interest on separate funds is property of the community from its inception and may be turned over to the

have to interest stem from rules that required – and after IOLTA still require – any interest that can be earned for his benefit be turned over to the client, not from a simple catch phrase.⁷ The notion that interest earned in an IOLTA account the instant before service charges are deducted or interest paid to TEAJF, is the “property” of each of the clients whose funds have been aggregated, is absurd as a matter of law and common sense.

Further support for Texas’ position can be found in the law of damages in takings cases generally, where the government must pay only the value of what the property owner lost, not the value of the property in the hands of the government. Brief of the United States at 20-22. Thus, where the property can be put to a more valuable use by the government (for example, because it has become part of a larger parcel or because existing zoning restrictions are eliminated), the former owner is

other spouse upon divorce. Pet. Br. at 22. While Respondents urge – with no supporting citation – this is merely evidence of some implied agreement between the spouses, it is not. Rather, it is a result of a Texas statute that so mandates, notwithstanding the supposed inviolate rule that “interest follows principal.” *Id.* at 22-23. In the case of the income-only trust, Respondents urge that this shows only that the trust agreement can separate interest and principal. This, however, is precisely the point. Interest follows principal only if the parties have so provided or if Texas law compels it, not because interest is an inalienable property right that cannot be divorced from title to principal.

⁷ In fact, where a transaction includes a deposit to secure a service, there is normally no reasonable expectation to interest income in the absence of some agreement to that effect. If, for example, a hotel required a \$100 deposit to hold a room, a traveler who canceled his reservation and received a refund would not reasonably expect to also receive “his share” of the interest the hotel received on the use of his funds in the meanwhile (especially where the costs would exceed that amount).

not entitled to receive any of the new value, on the theory that it was added by the government and not taken from the prior owner. Similarly, if the Government permitted low, but noiseless, flights over a property owner’s beautiful garden, there would be a taking only if the owner lost something, not just because the viewer gained something. In short, Respondents’ theory, which disregards what the client lost and focuses instead on what IOLTA gained, is wholly inconsistent with this aspect of the law of takings.⁸

According to Respondents’ theory, Summers must be given a constitutional windfall, by becoming entitled to receive, or at least to prevent others from receiving, the benefit of earning interest that, because of the laws of Texas and the United States (both banking and tax), as well as the laws of economics, he would never have received. We know of no constitutional doctrine, whether part of the jurisprudence of the Takings Clause or the Due Process Clause, that would compel, or even permit, such a bizarre result. Respondents’ attempts to take the sweet without the bitter (interest without the associated costs of producing and delivering it) must be rejected.

B. The Record Conclusively Establishes That Neither Summers Nor Any Other Texas Client Has Had Net Interest Taken By The Texas IOLTA Program.

Finally, on page 36 of their brief, Respondents reach their fallback point: even if net interest is the proper focus, they still win because “[e]vidence in the record indicates that, virtually always, clients benefit if their

⁸ In the bankruptcy context, this Court recently recognized the need to take into account offsets comparable to the costs of earning interest. *Associates Commercial Corp. v. Rash*, 117 S. Ct. 1879, 1886 n.6 (1997).

trust funds are deposited into interest bearing non-IOLTA accounts." The problem for Respondents is that neither their citation to pages 98-99 of the Joint Appendix, or anything else in the record supports that conclusion.

We start at the beginning, with the complaint (J.A. 2-17), which is not a class complaint, but an individual one brought on behalf of WLF, attorney Mazzone, and client Summers. Only Respondent Summers has any arguable property right at stake. Since this is an individual action, it is only the impact of IOLTA on his funds, not on those of "virtually" every client on which this case must be judged. His complaint never alleges he would have earned net interest. In fact, in paragraph 36 (J.A. 12), he admits his own attorney told him that it would not earn net income if kept in a separate account. That concession ought to end the inquiry.

But there is more. After Petitioners' motions to dismiss were denied, the parties both moved for summary judgment. Thus, contrary to Respondents' suggestion (Resp. Br. at 37), this is hardly a case, like *Eastman Kodak*, where summary judgment is entered against a party who is complaining that discovery is incomplete.

Petitioners have established IOLTA only applies to those client trust funds that, after taking into account all proper charges, could not produce net income for the client. The most crucial affidavit was that of Respondent Summers, consisting of just nine numbered paragraphs and no exhibits. The only statement that bears on the factual issue of whether Summers' money could have earned interest for him, after paying associated expenses, is paragraph 6. In the final part of the second sentence, he describes the possibility of having his lawyer deposit his money in a separate account as "an infeasible option

because the cost of establishing and administering a separate account for my funds most likely would exceed any interest that could be earned on those funds." J.A. 86.⁹

Most significantly, there is *no* evidence, any place in the record, to show that if Summers' funds were deposited in a non-IOLTA account they would have produced net income to him. Mazzone himself testified that funds that are nominal in amount or held for a short term "cannot practically be placed into separate interest-bearing accounts, because the additional costs of establishing and maintaining such accounts usually would exceed any interest I could earn for my clients." J.A. 83, ¶ 4. Given that state of the record, it was not surprising that the district court also concluded that Summers had lost no net interest and therefore had no constitutional claim. Indeed, with cross-motions for summary judgment and with no request for additional discovery on this issue, the trial court had no choice but to enter summary judgment for Petitioners. *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986).

In this Court, Respondents rely heavily on the affidavit of Robert J. Randell (J.A. 94-105), who is alleged to be a banking expert and who claims that interest can be earned on most accounts through the device of sub-accounting, particularly given the capabilities of modern computers. Despite its seeming relevance, reliance on the Randell affidavit is doubly flawed. Just as this Court found similar affidavits offered to avoid summary judgment to be inadequate in *Lujan v. Defenders of Wildlife*, 504

⁹ The Fifth Circuit panel took the position that the costs of complying with the mandatory reporting provisions of the "fickle tax code" (Pet. App. 16a-17a, n.47) were irrelevant. The Internal Revenue Code may or may not be fickle, but the obligations it creates cannot be ignored, and if they impose costs on someone, those costs must be paid (or absorbed) and are not to be ignored in determining whether deposits of a client produce net income.

U.S. 555 (1992), and *Lujan v. National Wildlife Fed'n*, 497 U.S. 871 (1990). Randell's affidavit also fails to make the necessary connection to the facts of this case.

First, the Randell affidavit does not mention Mr. Summers or his deposits, nor does it attempt to show how any plaintiff in this case was injured by the Texas IOLTA program by being deprived of net income which he otherwise would have earned from his trust fund deposit. Second, all of his discussion and his examples are from New York and New Jersey, not Texas where this case arises. Randell may or may not be correct about what happens elsewhere, but this case involves the Texas IOLTA program, and he fails even to assert that the results he claims for New York would obtain in Texas. There was, therefore, no point in challenging Randell's assertions because they had nothing to do with this case, which involved one client in one state. Had Congress or a federal agency been considering this issue, they might have explored the ramifications of Randell's general assertions, but a district court in Texas, passing on a specific case dealing with a Texas client and Texas banks, would have committed error had it relied on such general claims as made by Mr. Randell.

Furthermore, nowhere in the record is there any evidence as to the exact amount of Mr. Summers' deposit – it is described in the complaint as a "small amount" (J.A. 12, ¶ 7) and in his affidavit as "a small retainer fee" (J.A. 86, ¶ 4). Nor does the record show how long the money was actually held by his attorney so that the Court, Petitioners, or even Mr. Randell could calculate approximately how much interest might have been earned and what the costs might have been. Thus, on this record, even if one wanted to attempt to determine whether Mr. Summers' money might have earned net interest while held by his counsel, it would be impossible because even

the most basic data is lacking, despite the fact Respondents moved for summary judgment themselves.¹⁰

The Fifth Circuit panel never analyzed the case in this manner, but that may be partially due to the fact that this case was not structured as a typical takings case in which one or more plaintiffs sues for money damage for a specific loss from a specific governmental taking of a specific piece of property. The relief sought here is principally prospective, designed to shut down the IOLTA program as a whole, and not just to prevent future takings of interest on money deposited by Mr. Summers with his lawyers. There is a claim for a refund of money damages, but that was rejected on Eleventh Amendment grounds by both lower courts, and this Court denied certiorari on the question. (Cert. Pet. App. pp. 17-18; 37-38).¹¹

Leaving aside the question of whether an injunctive action may ever be brought to remedy a claim of taking

¹⁰ Mr. Summers' real dispute may be with his lawyer, not with IOLTA. His affidavit indicates that the deposit was intended to be used if he failed to pay his legal bills, rather like a tenant's rent escrow, and that it may still be on deposit (J.A. 85-86 ¶ 3). If that is the case, his lawyers probably should not have put his money in an IOLTA account. However, that is not a loss for which Petitioners are responsible.

Nor is there anything to Respondents' assertion that IOLTA rules preclude, or even appear to preclude, attorneys from using sub-accounts where their use could result in net interest being earned by their clients. There is no support in this record for any claim that any official pronouncement or rule of Petitioners operated in that manner, or even was a factor in any attorney not using a sub-account. Moreover, the only arguably relevant fact in this case is whether any attorney used by Mr. Summers was misled in that regard. On that point, there is not even a shred of evidence to support such a claim.

¹¹ Curiously, Respondents' prayer for relief (J.A. at 16) demands a refund for "Plaintiffs' money" even though the only money in this case belongs to plaintiff Summers.

without just compensation,¹² if this case had been brought as a traditional takings claim, all of the efforts to avoid the issue of whether Mr. Summers had any amount of net interest taken from him would have been exposed. Surely, in such a case, he could never have sought summary judgment without submitting basic data about the alleged taking, and surely no Texas court would have paid the slightest attention to the Randell affidavit, unless it made some effort to connect its general assertions to the facts of this case or at least to Texas banking practices generally. And equally certain, although Respondents have attempted to camouflage this as a Section 1983 case that cannot negate their obligation to support their claim with factual evidence needed to determine whether any of Mr. Summers' property was actually taken. Plainly, a party who cross-moves for summary judgment without adequate supporting factual evidence, and who fails to contend that the record needed more development before the Court could decide the motions, cannot subsequently object to that record. *See Celotex*, 477 U.S. at 323-26. And on this record, the district court was clearly correct in entering summary judgment for Petitioners.

* * *

Much as Respondents might wish otherwise, the federal courts do not have a roving commission to rummage through IOLTA's rules and practices to find parts that might violate the Constitution. Rather, it is the duty of federal courts to examine the claims of the parties before them, sift the evidence presented by them, and determine whether any of the rights asserted have been violated.

¹² See *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1016 (1984) ("[e]quitable relief is not available to enjoin an alleged taking of private property for a public use . . . when a suit for compensation can be brought against the sovereign subsequent to the taking") (footnote omitted).

Respondents have not shown any cognizable property right. Indeed, the record in this case is crystal clear no property interest of any of the three plaintiffs has been violated at all, let alone by Petitioners or the Texas IOLTA program. The district court correctly understood no property right was infringed by the Texas IOLTA program. In contrast, the Fifth Circuit panel failed to moor its ruling to the facts, as cabined by the laws governing bank accounts and those establishing reporting obligations under the Internal Revenue Code. Because none of the Respondents has suffered any injury to their property, the judgment of the Fifth Circuit should be reversed, with directions to reinstate the judgment of the district court in favor of Petitioners.

Respectfully submitted,

NANCY TREASE
Office of the Attorney
General of Texas
P.O. Box 12548,
Capitol Station
Austin, TX 78711
(512) 475-4075

Attorneys for Petitioners
Hon. Thomas R. Phillips,
Hon. Raul A. Gonzalez,
Hon. Nathan L. Hecht,
Hon. John Cornyn, Hon.
Craig T. Enoch, Hon.
Rose Spector, Hon.
Priscilla Owen, Hon.
James A. Baker, Hon.
Greg Abbott, In Their
Official Capacities as
Justices of the Texas
Supreme Court

DARRELL E. JORDAN*
BRITTAN L. BUCHANAN
DAVID J. SCHENCK
BETH W. BIVANS

HUGHES & LUCE, L.L.P.
1717 Main Street,
Suite 2800
Dallas, TX 75201
(214) 939-5500
Attorneys for Petitioners
Texas Equal Access to
Justice Foundation, And
W. Frank Newton, In His
Official Capacity As
Chairman Of The Texas
Equal Access To Justice
Foundation

*Counsel of Record

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In the Supreme Court of the United States

OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, ET AL., PETITIONERS

v.

WASHINGTON LEGAL FOUNDATION, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

**BRIEF FOR THE
UNITED STATES AS AMICUS CURIAE
SUPPORTING PETITIONERS**

WALTER DELLINGER
Acting Solicitor General

FRANK W. HUNGER

LOIS J. SCHIFFER
Assistant Attorneys General

EDWIN S. KNEEDLER
Deputy Solicitor General

PATRICIA A. MILLETT
*Assistant to the Solicitor
General*

ROBERT KLARQUIST

TIMOTHY DOWLING

JARED A. GOLDSTEIN
Attorneys

*Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217*

40 178

QUESTION PRESENTED

Whether interest earned on client trust funds held by lawyers in the Interest on Lawyers Trust Accounts (IOLTA) program is a property interest of the client or lawyer, cognizable under the Fifth Amendment to the United States Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could not earn interest for the client or lawyer.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-1578

HON. THOMAS R. PHILLIPS, ET AL., PETITIONERS

v.

WASHINGTON LEGAL FOUNDATION, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE
UNITED STATES AS AMICUS CURIAE
SUPPORTING PETITIONERS

INTEREST OF THE UNITED STATES

This case presents the issue of what type of interests constitute "private property" protected by the Just Compensation Clause of the Fifth Amendment to the United States Constitution. Because that Clause applies directly to the programs and operations of the federal government, the United States has a vital interest in the Court's construction of that constitutional provision. Due to the size and national scope of the federal government's operations, moreover, its programs can often employ property in a manner that creates or enhances value that could not be realized by individual owners. The determination whether

such government-created value constitutes "private property" thus could affect significantly the federal government's responsibilities and liability under the Fifth Amendment. In addition, this case will address the interrelationship of interest on deposit accounts, which the federal government regulates, and the constitutional definition of "private property." Finally, the United States has an interest in equitable access to the justice system, and in ensuring that IOLTA programs, which have been developed in virtually all States, are not undermined by an interpretation of the Just Compensation Clause that departs from settled practices and understandings.

STATEMENT

1. In the course of their practice, attorneys are frequently required to hold client funds for a certain period of time. Like every other State, Texas has established ethical rules of conduct that regulate how attorneys must handle client funds. Texas Bar Rule 1.14(a) provides that lawyers "shall hold funds and other property belonging in whole or in part to clients * * * separate from the lawyer's own property." Texas Bar Rules, Art. X, § 9 (1997). Funds must be kept in a distinct "'trust' or 'escrow' account." *Ibid.* The account must permit withdrawal on demand. Pet. App. 2a; Texas Bar Rules, Art. X, § 9, Rule 1.14(b).

Occasionally, client funds provided to a lawyer are so nominal in amount or are held for so short a period of time that either they cannot be expected to earn interest or any interest earned would be offset by the administrative expense of opening and maintaining a separate account. See Pet. App. 3a.¹ Traditionally, attorneys deposited such

¹ Examples of such client funds include real estate escrow funds, advance payments of costs and filing fees, retainers, and settlement funds.

funds into a single, pooled, non-interest bearing account. *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962, 968 (1st Cir. 1993) (citing additional cases). The depository institution thus retained for itself whatever interest value the deposited funds generated. *Ibid.*

In 1980, Congress authorized the creation of Negotiable Order of Withdrawal (NOW) accounts, which both bear interest and leave the funds available for immediate withdrawal. 12 U.S.C. 1832. NOW accounts are permitted only for deposits that "consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, political, or other similar purposes and which is not operated for profit." 12 U.S.C. 1832(a)(2); see also 12 C.F.R. 204.130. For-profit corporations and partnerships are thus prohibited from receiving interest on demand deposits.

In 1984, Texas adopted an Interest on Lawyers Trust Account (IOLTA) program. Pet. App. 3a. Under the IOLTA program, attorneys continue to pool into a single deposit account those client funds that "are nominal in amount or are reasonably anticipated to be held for a short period of time." Texas Bar Rules, Art. XI, § 5(A); Rules Governing the Operation of the Texas Equal Access to Justice Program (IOLTA Rule) 4 (1997). The Texas IOLTA rules require, however, that attorneys deposit their pooled funds into an interest-bearing NOW account, rather than into a non-interest-bearing, demand account. *Ibid.*² The interest generated by each attorney's IOLTA

² In an opinion letter issued in 1981, the General Counsel of the Federal Reserve Board concluded that NOW accounts could be employed by Florida's IOLTA program. Letter from General Counsel Bradfield to D. Middlebrooks (Oct. 15, 1981), reprinted in D. Middlebrooks, *The Interest on Trust Accounts Program: Mechanics of its Operation*, 56 Fla. B.J. 115, 117 (Feb. 1982). The Board has provided similar letters

account is paid to the Texas Equal Access to Justice Program, a non-profit corporation established by the Texas Supreme Court. Texas Bar Rules, Art. XI, §§ 3, 4; IOLTA Rules 1, 2. The Texas Equal Access to Justice Program distributes the funds to non-profit organizations that "have as a primary purpose the delivery of legal services to low income persons." IOLTA Rule 10; see also Texas Bar Rules, Art. XI, § 2(B); Pet. App. 4a.

The Texas program requires that client funds be deposited in IOLTA accounts only if, due to their small amount or to the short duration of time for which they are held, the attorney determines that

such funds, considered without regard to funds of other clients which may be held by the attorney, law firm or professional corporation, could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client.

IOLTA Rule 6.³ If an attorney initially determines that client funds should be deposited in an IOLTA account, the

to virtually every jurisdiction operating an IOLTA program. Texas received letters from the Board and the Federal Deposit Insurance Corporation in August 1985 advising that its IOLTA funds were eligible for deposit in a NOW account. (We have lodged copies of the Texas letters with the Clerk of the Court.)

³ IOLTA Rule 6 provides that the decision whether client funds are incapable of generating interest should be made "without regard to funds of other clients which may be held by the attorney." That restriction prevents an attorney from using the funds of multiple clients to generate interest for a single client or using other clients' funds to pay the administrative costs incurred in earning interest for a single

attorney thereafter "should review at reasonable intervals whether changed circumstances" (such as a delay in litigation) will permit the client funds to generate realizable interest; if so, the attorney is expected to transfer the funds to an account that earns interest for the client. *Ibid.*⁴

The Internal Revenue Service does not attribute the interest generated by an IOLTA account to the individual clients or lawyers for federal income tax purposes, because they do not have control over the decision whether to place the funds in the IOLTA account and they do not designate who will receive the interest from the account. Rev. Rul. 81-209, 1981-2 C.B. 16; see also Rev. Rul. 87-2, 1987-1 C.B. 18.⁵

client. Where, however, an attorney can pool nominal or short-term client funds and generate sufficient interest to offset the administrative costs of sub-accounting and apportioning the interest among all clients in the pool, the attorney must create an interest-bearing account for the clients, rather than deposit the funds in an IOLTA account. Pet. App. 24a n.2; Reply Br. Pet. Stage 2 n.1; Texas Bar Rules, Art. XI, § 5(B); cf. IOLTA Rule 22 (nothing in IOLTA can require an attorney to take any action that violates the Texas Code of Professional Responsibility, Texas Bar Rules, Art. X, § 9). Because of the limitations on NOW accounts, however, only the funds of individual or non-profit clients can be included in such a pool.

⁴ If the attorney does not have access to a depository institution that will pay interest on such pooled, demand accounts, then the attorney "is required to maintain a non-interest bearing client trust account for such funds." IOLTA Rule 4B.

⁵ Since the 1981 Revenue Ruling, the Internal Revenue Service has provided private letter rulings to numerous jurisdictions with IOLTA programs advising that the interest created by their programs will not be attributed to the clients or lawyers as taxable income. *E.g.*, Priv. Ltr. Rul. 85-27-058, 1985 WL 293058 (Apr. 9, 1985); Priv. Ltr. Rul. 84-28-087, 1984 WL 266482 (Apr. 11, 1984); Priv. Ltr. Rul. 83-16-108, 1983 WL 198254 (Jan. 19, 1983).

Currently, 48 States and the District of Columbia have adopted analogous IOLTA programs.⁶ In addition to Texas, twenty-six States make attorneys' participation in

⁶ See Ala. R.P.C. 1.15(g) (Michie 1996); Alaska R.P.C. 1.15(d) (1997); Ariz. Sup. Ct. R. 44(c)(2) (West 1997); Ark. R.P.C. 1.15(d)(2) (Michie 1997); Cal. Bus. & Prof. Code § 6211(a) (West 1990); Colo. R.P.C. 1.15(e)(2) (West 1997); Conn. R.P.C. 1.15(d) (West 1996); Del. R.P.C. 1.15(h) (Michie 1997); D.C. R. Ct. App. B(a) (West 1997); Fla. Bar R. 5.1-1 (West 1997); Ga. C.P.R. DR 9-102(C) (Michie 1997); Haw. Sup. Ct. R. 11 (Michie 1997); Idaho R.P.C. 1.15(d) (West 1997); Ill. R.P.C. 1.15(d) (West 1997); Iowa C.P.R. DR 9-102 (West 1997); Kan. R.P.C. 1.15(d)(3) (West 1997); Ky. Sup. Ct. R. 3.130 (Michie 1997); La. R.P.C. 1.15(d) (West 1997); Me. C.P.R. 3.6(e)(4) (West 1996); Md. Bus. Occ. & Prof. Code Ann. § 10-303 (1995); Mass. Sup. Ct. R. 3:07 (West 1997); Mich. R.P.C. 1.15(d) (West 1997); Minn. R.P.C. 1.15(d) (West 1997); Miss. R.P.C. 1.15(d) (West 1996); Mo. R.P.C. 1.15(e) (West 1997); Mont. R.P.C. 1.18(b) (West 1997); Neb. Sup. Ct. R. Trust Acct. (West 1997); Nev. Sup. Ct. R. 217 (Michie 1996); *In re New Hampshire Bar Ass'n*, 453 A.2d 1258 (N.H. 1982); N.J. R. Gen. App. 1:28A-2 (West 1997); N.M. R.P.C. 16-115(D) (Michie 1995); N.Y. Jud. Law § 497 (McKinney Supp. 1997); N.C. R.P.C. 10.3 (West 1997); N.D. R.P.C. 1.15(d)(1) (West 1997); Ohio Rev. Code Ann. § 4705.09(A)(1) (Anderson 1997); Okla. R.P.C. 1.15(d) (West 1997); Ore. C.P.R. DR 9-101(D)(2) (West 1997); Pa. R.P.C. 1.15(d) (West 1997) & Pa. R. Disc. Enf. 601(d) (West 1997); S.C. App. Ct. R. 412 (Law. Co-op. 1988); S.D. R.P.C. 1.15(d)(4) (Michie 1995); Tenn. C.P.R. DR 9-102(C)(2) (West 1996); *In re Interest on Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); Va. Sup. Ct. R. Pt. 6, § 4, ¶ 20 (Michie 1997); Vt. C.P.R. DR 9-103 (West 1996); Wash. R.P.C. 1.14(c)(1) (West 1997); W. Va. R.P.C. 1.15(d) (Michie 1997); Wis. Sup. Ct. R. 13.04, 20:1.15 (West 1997); Wyo. R.P.C. 1.15(II) (Michie 1997); see also ABA/BNA, *Lawyers' Manual on Professional Conduct* § 45:201 (1997). Indiana is the only State that has not implemented an IOLTA program. See *In re Indiana State Bar Ass'n Petition*, 550 N.E.2d 311 (Ind. 1990). IOLTA programs also operate in every Canadian province, South Africa, Namibia, Zimbabwe, and five Australian states. T. Gonser, D. Almond & F. Ziegler, *Financing Public Services Activities with Interest-Bearing Attorney Trust Accounts*, 15 Idaho L. Rev. 219, 221 & n.6 (1979).

the program mandatory.⁷ The remaining jurisdictions operate IOLTA programs in which participation by attorneys is voluntary.⁸

2. The respondents in this Court are the Washington Legal Foundation; Michael Mazzone, a Texas attorney; and William Summers, a Texas client with funds deposited in an IOLTA account. They filed suit in the United States District Court for the Western District of Texas against petitioners, the Texas Equal Access to Justice Foundation; W. Frank Newton, chair of the Foundation; and the nine individual Justices of the Texas Supreme Court, alleging that the Texas IOLTA program violates the Fifth and Fourteenth Amendments because it unconstitutionally takes private property—the interest generated on IOLTA accounts—without just compensation. J.A. 2-17.

The district court granted summary judgment in favor of petitioners. Pet. App. 20a-40a. The court of appeals reversed, relying in large part on this Court's decision in

⁷ Those additional States are Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Illinois, Iowa, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Montana, New Jersey, New York, North Dakota, Ohio, Oregon, Pennsylvania, Vermont, Washington, West Virginia, and Wisconsin.

⁸ In some of those jurisdictions, participation is expressly made voluntary (New Mexico, Oklahoma, and South Dakota), while others contain opt-out provisions (Alabama, Alaska, Delaware, District of Columbia, Idaho, Kansas, Kentucky, Maine, Mississippi, Missouri, Nebraska, Nevada, New Hampshire, North Carolina, Rhode Island, South Carolina, Tennessee, Utah, Virginia, and Wyoming). Because respondents challenge only the mandatory aspect of Texas's IOLTA program (see J.A. 16), this case presents no occasion for the Court to address whether voluntary IOLTA programs create "private property" within the meaning of the Fifth Amendment.

⁹ The complaint also asserts a violation of respondents' speech and associational rights under the First Amendment. J.A. 14.

Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155 (1980). Pet. App. 1a-19a.

A divided court of appeals denied petitioners' suggestion of rehearing en banc. Pet. App. 41a-52a. Four of the six dissenting judges emphasized that, to rise to the level of "property" under the Just Compensation Clause, the interest at issue must "have some actual or potential compensable value that could accrue to the benefit of its owner." *Id.* at 48a. The just compensation prong of the Clause, however, would afford respondents "nothing," because the "fair market value of the earnings of IOLTA-eligible funds is \$0." *Id.* at 49a. The dissent further found "both ironic and fatal to [respondents'] claim that in order to have a property interest in this case, they must rely on the existence of the program they seek to eliminate." *Id.* at 48a.

SUMMARY OF ARGUMENT

The IOLTA program, by generating interest that could not otherwise be realized, does not take the individual clients' "private property," within the meaning of the Fifth Amendment. There is no question that the underlying funds are, and at all times remain, the property of the client. The issue is whether the government's temporary regulation of how those funds are managed while in the custody of the client's attorneys deprives the client of any recognized property right. It does not. The client has no reasonable expectation that the funds given over to the attorney will generate interest during that time. Because the individual client cannot control how the attorney handles other clients' money, moreover, the client has no reasonable prospect of enhancing the interest-earning capacity of his funds by pooling his money with others.

Respondents thus seek to claim as their personal property a value that a client's individual funds simply are incapable of generating. IOLTA interest is realized only

through the application of governmental capabilities and resources. This Court's Fifth Amendment jurisprudence focuses, however, on what the owner has lost, not on what the government has gained. Individuals may not claim as a property loss, entitled to just compensation, value that the government has created. Indeed, respondents' claimed property right to IOLTA interest, if recognized, would create an unworkable incongruity between the property that the Just Compensation Clause protects and the property values that the Clause reimburses.

ARGUMENT

INTEREST GENERATED THROUGH THE IOLTA PROGRAM IS A GOVERNMENT-CREATED VALUE AND THUS IS NOT "PRIVATE PROPERTY" WITHIN THE MEANING OF THE FIFTH AMENDMENT

A. Introduction

The term "private property" in the Just Compensation Clause of the Fifth Amendment denotes "the group of rights inhering in the citizen's relation to the physical thing, as the right to possess, use and dispose of it." *PruneYard Shopping Ctr. v. Robins*, 447 U.S. 74, 82 n.6 (1980).¹⁰ The question whether interest earned on an IOLTA account qualifies as a "right[] inhering in" respondents' relation to their individual funds is ultimately a question of federal constitutional law. *United States v. Powelson*, 319 U.S. 266, 279 (1943). This Court has recognized, however, that the Constitution does not create property rights. Rather, property rights "are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as

¹⁰ The Fifth Amendment's Just Compensation Clause applies to the States through the Fourteenth Amendment. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 122 (1978).

state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.” *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972);¹¹ see also *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1030 (1992); *United States v. Willow River Power Co.*, 324 U.S. 499, 502 (1945) (“not all economic interests are ‘property rights’; only those economic advantages are ‘rights’ which have the law back of them”). For that reason, respondents’ property claim must be evaluated in light of the specific regulatory framework and factual context in which it arises.

There can be no doubt that the client funds underlying the IOLTA program are the property of respondents. Nothing in IOLTA affects that property interest. Those funds remain at all times fully and freely available to respondents upon demand. Funds are regulated under the IOLTA program only after a client has made an independent decision to segregate and dedicate his funds to a specified legal activity or service. IOLTA thus does not implicate funds that a client could otherwise employ to earn interest by, for example, depositing in a bank account or pooling with other personal assets.

When clients choose to deposit money with their attorneys, they create a relationship that is subject to the States’ “compelling interest in the practice of professions within their boundaries, and * * * broad power to establish standards for * * * regulating the practice of professions.” *Florida Bar v. Went For It, Inc.*, 515 U.S.

¹¹ *Roth* interpreted the scope of “property” under the Due Process Clause, which may not be coterminous with the “private property” protected by the Just Compensation Clause. See *Pittman v. Chicago Bd. of Educ.*, 64 F.3d 1098, 1104 (7th Cir. 1995), cert. denied, 116 S. Ct. 2497 (1996); cf. *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 224 (1986); *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 430-431 (1982).

618, 625 (1995). The client is charged with knowledge that the State will regulate the handling of his funds for the protection of the integrity of the legal system. With respect to IOLTA programs, then, governmental regulation of private property commences, not with the collection of interest, but with the imposition of ethical strictures that require counsel to deposit the funds in a banking institution and compel counsel, as a matter of financial practicality, to pool short-term and nominal client funds in a single account.

Respondents do not question Texas’s authority to impose ethical regulations on how attorneys handle client funds. Nor do they challenge the requirement that their funds be deposited in a banking institution or the practical necessity for counsel to pool short-term and nominal client funds into a single account. Finally, respondents do not contend that the pre-IOLTA regulatory scheme, under which nominal and short-term client funds were deposited into a non-interest bearing account, took their private property, even though the consequence of that legal regime was that their funds generated interest value for the exclusive enjoyment of the depository institution. See *Cone v. State Bar of Florida*, 819 F.2d 1002, 1005 (11th Cir.) (“Before the initiation of the [IOLTA program], the only beneficiaries of the old regime were the banks, who were treated to ‘free’ use of trust account deposits.”), cert. denied, 484 U.S. 917 (1987); *In re Interest on Lawyers’ Trust Accounts*, 675 S.W.2d 355, 357 (1984) (“At present, the earnings of funds held in trust accounts can benefit neither the attorney nor the client, but simply redound to the benefit of the depository institution.”), modified, 689 S.W.2d 352 (1985), modified, 709 S.W.2d 400 (1986), amended, 738 S.W.2d 803 (Ark. 1987); J.A. 74-75. The question presented in this case therefore is whether, simply by requiring that the interest earned on the pooled funds be

provided to the Texas Equal Access to Justice Foundation rather than to the depository institution, IOLTA gave birth to a private property claim to the interest.¹²

B. Because Respondents Had No Reasonable, Investment-Backed Expectation That Their Funds Would Generate Interest, The Proceeds Of The IOLTA Account Are Not Respondents' Property

IOLTA does not physically appropriate client funds, nor does it deprive client funds of any—let alone all—economically beneficial or productive use of their money. See *Lucas*, 505 U.S. at 1014-1015; see also *PruneYard Shopping Ctr.*, 447 U.S. at 84. It is, moreover, the client's decision to set the nominal or short-term funds aside for legal services that prevents them, temporarily, from generating interest or being put to other productive use. IOLTA simply regulates the interest-bearing capacity of funds while in the custody of state-licensed attorneys and governmentally regulated banks. See *Yee v. City of Escondido*, 503 U.S. 519, 522-523, 527-528 (1992) (distinguishing, for purposes of Fifth Amendment analysis, between per se takings of property and governmental regu-

¹² Almost every court that has addressed the question has held that an IOLTA program does not result in a taking of private property in violation of the Fifth Amendment. *Massachusetts Bar Found.*, 993 F.2d at 973-974; *Cone*, 819 F.2d at 1004-1007; *In re Massachusetts Bar Ass'n*, 478 N.E.2d 715, 718 (Mass. 1985); *IOLTA Adoption Order*, 102 Wash.2d 1101, 1101-1109 (1984); *In re Minnesota State Bar Ass'n*, 332 N.W.2d 151, 158 (Minn. 1982); *In re New Hampshire Bar Ass'n*, 453 A.2d 1258, 1261 (N.H. 1982); *In re Interest on Trust Accounts*, 402 So. 2d 389, 395-396 (Fla. 1981); *Carroll v. State Bar of California*, 213 Cal. Rptr. 305, 311-312 (Cal. Ct. App.), cert. denied, 474 U.S. 848 (1985); see also *In re Interest on Lawyers' Trust Accounts*, 672 P.2d 406, 408 (Utah 1983); *In re Interest on Lawyers' Trust Accounts*, 675 S.W.2d at 356-358. But see *In re Indiana State Bar Ass'n Petition*, 550 N.E.2d at 312; *In re Interest on Trust Accounts*, 402 So. 2d at 399 (Boyd, J., dissenting).

lation of how property is used); cf. *United States v. Sperry Corp.*, 493 U.S. 52, 62 & n.9 (1989) (retention of a percentage of monetary award roughly equivalent to administrative costs does not effect a permanent physical occupation of property and thus is not a per se taking).

1. In challenging IOLTA's regulatory program as a taking of private property, respondents must show that the program deprives them of "interests that were sufficiently bound up with the reasonable expectations of [respondents] to constitute 'property' for Fifth Amendment purposes." *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 125 (1978). Respondents, in other words, must demonstrate that they had a concrete and justifiable expectation of earning interest on funds while in their attorneys' custody, if they wish to claim IOLTA interest as their own. They can make no such showing.

In the complaint, as well as in an affidavit filed in support of respondents' motion for summary judgment, respondent Mazzone acknowledged that the nominal and short-term funds he holds for clients "cannot practicably be placed into separate interest-bearing accounts, because the additional costs of establishing and maintaining such accounts usually would exceed any interest I could earn for my clients." J.A. 83; see also J.A. 10. Respondent Summers, a client, likewise characterized the creation of an independent account for his funds to be "an unfeasible option because the cost of establishing and administering a separate account for my funds most likely would exceed any interest that could be earned on those funds." J.A. 86; see also J.A. 12. Respondents thus concede that they had no reasonable expectation that the funds the clients deposited with their lawyers would generate interest for their benefit.¹³

¹³ See also Formal Op. 348, 68 A.B.A. J. 1502, 1506 (July 1982) ("The client has no right under the circumstances to require the payment of

Respondents also could not reasonably expect that interest would be realized for them by pooling their funds with the money of other clients. First, Texas's IOLTA program, by definition, does not apply if the attorney can pool nominal or short-term client funds and generate sufficient interest to offset the administrative costs of sub-accounting and apportioning the interest among all clients in the pool. IOLTA Rule 6; Texas Bar Rules, Art. XI, § 5(B); see also Pet. App. 24a n.2; Pet. Reply 2 n.1.

Second, individual clients have no right inhering in the traditional attorney-client relationship to require counsel to pool their funds with the money of other clients. Rather, the focus of an attorney's ethical duty in managing client funds is "on safekeeping, accounting, and delivery, and not on investment of the funds." Formal Op. 348, 68 A.B.A. J. 1502, 1503 (July 1982); see also *In re Interest on Trust Accounts*, 402 So. 2d 389, 394 (Fla. 1981); IIA A. Scott & W. Fratcher, *The Law of Trusts* § 180 (deposit of trust fund into bank account "is usually not a form of investment but is a method of safekeeping"), § 181 (where purpose of trust is to safeguard funds, trustee bears no duty to make the trust productive) (4th ed. 1987). Nor have respondents demonstrated a reasonable expectation that other clients would wish to pool their funds with them.¹⁴ Respondents thus can make no argument that the IOLTA program diminishes the economic value of their

any interest on the funds to himself or herself because the amount of interest which the funds could earn is likely to be less than the appropriate charges for administering the earnings.").

¹⁴ For those same reasons, the court of appeals' speculation that a single attorney's clients might agree to pool their funds for the benefit of a single charity (Pet. App. 15a) does not provide a sound basis for recognizing a property right in individual clients in the interest earned on an IOLTA account.

funds or deprives them of any independent capacity to dedicate their money to more fruitful endeavors.

2. Nothing in the law, either preceding adoption of the IOLTA program or presently, "secured" respondents' "claim of entitlement to" IOLTA interest. *Roth*, 408 U.S. at 577. As they concede, nothing in prior banking laws or regulations permitted a client's limited funds to realize interest while on deposit in a demand account. Texas law guaranteed that interest would accrue to the benefit of the principal's owner when (i) interest was actually realized by the individual property, (ii) the amount of the interest exceeded the reasonable costs of managing the account, and (iii) the claimant owned the entire fund generating the interest. See *Sellers v. Harris County*, 483 S.W.2d 242, 243-244 (Tex. 1972). The client moneys at issue in this case satisfy none of those conditions.

Nor can respondents claim that the right to accrue interest on deposits is a property value traditionally recognized as "inhering in the citizen's relation to" money. *PruneYard Shopping Ctr.*, 447 U.S. at 82 n.6. To the contrary, government has historically regulated the capacity of money to earn interest, by setting the terms and conditions under which interest will be paid on bank deposits in order to promote the public good.

Under the common law, "interest could in no case be recovered," and, indeed, the concept of paying interest "was held in detestation." *National Bank of the Commonwealth v. Mechanics' Nat'l Bank*, 94 U.S. (4 Otto.) 437, 438 (1876); see also S. Perley, *Principles of the Law of Interest* 1 (1893) ("In early times, in conformity to the canons of the church, all interest whatever upon money loaned was prohibited. To take [interest] was, also, *in foro conscientiae*, punished as a crime next to that of murder.")

(footnote omitted).¹⁵ As a result, the ability to obtain interest has never been understood as an entitlement or a right. Until the latter half of the nineteenth century, the purpose of depositing money in a bank was generally for safekeeping, not to generate interest. 1 F. Redlich, *The Molding of American Banking: Men and Ideas* 7, 13-14 & n.99 (1968). A depositor could claim interest only if it was specified by contract. *Parkersburg Nat'l Bank v. Als*, 5 W. Va. 50, 55-56 (1871); *Haswell v. Farmers & Mechanics' Bank*, 26 Vt. 100, 103-104 (1853); *Jones v. Mallory*, 22 Conn. 386 (1853); Perley, *supra*, at 5.¹⁶

During this century, "governmental controls of American banking [became] manifold." *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 327 (1963). Indeed, this Court has described federal banking regulations as "the outstanding example in the federal government of regulation of an entire industry through methods of supervi-

¹⁵ In 1545, the outright prohibition on paying interest of any sort was repealed by statute. A Bill Against Usury, 37 Hen. 8, ch. 9 (1545), cited in P. Siegel, *Interest on Lawyers' Trust Account Programs: Do They "Take" "Property" of the Client?*, 36 U. Fla. L. Rev. 674, 683 n.43 (1984).

¹⁶ In the mid-nineteenth century, competition by banks for deposits led to the payment of ever-increasing interest rates, and the excessive interest paid on deposits was seen as a leading cause of the bank failures of 1857, 1873, and 1885. A. Cox, *Regulation of Interest Rates on Bank Deposits* 3-5 (1966). The Comptroller of the Currency concluded that the payment of interest on deposits "has done more than any other to demoralize the business of banking." *Annual Report of the Comptroller of the Currency*, H.R. Exec. Doc. No. 3, 43d Cong., 1st Sess. 31 (1873). The Comptroller accordingly endorsed self-regulation by the banking industry to limit or eliminate interest on deposits. *Ibid.* Well into the 1920s, the federal government continued to pressure banks to limit the interest they paid on deposits. See Federal Reserve Bulletin, VI, at 157 (Feb. 1920) ("[W]e recommend to the banks and trust companies in the various Federal Reserve districts that no rate in excess of 2 1/4 per cent be paid."); Cox, *supra*, at 8.

sion." *Id.* at 330. Of particular relevance to this case, in response to the bank failures of the 1920s and 1930s, Congress enacted the Banking Act of 1933, ch. 89, 48 Stat. 162, which prohibited Federal Reserve member banks from paying any interest on demand deposits. 12 U.S.C. 371a. In 1935, Congress similarly directed the FDIC to prohibit insured, non-member banks from paying interest on demand deposits. Banking Act of 1935, ch. 614, § 101, 49 Stat. 702 (codified at 12 U.S.C. 1828(g)). Congress later directed the Secretary of the Treasury, the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), and the Federal Home Loan Bank Board to implement their respective powers "to bring about the reduction of interest rates to the maximum extent feasible in the light of prevailing money market and general economic conditions." Act of Sept. 21, 1966, Pub. L. No. 89-597, § 1, 80 Stat. 823. In 1973, Congress extended to all depository institutions the prohibition on paying interest on demand deposits. Act of Aug. 16, 1973, Pub. L. No. 93-100, § 2, 87 Stat. 342; see also 12 U.S.C. 1464(b)(1)(B). In addition, the Federal Reserve Board and the FDIC capped the interest rate that banks could pay on all other types of accounts. 12 C.F.R. 217.7 (Federal Reserve Board Regulation Q), 329.6 (FDIC regulation) (1974).

Beginning in 1978, with the enactment of the Financial Institutions Regulatory and Interest Rate Control Act, Pub. L. No. 95-630, 92 Stat. 3641, Congress eased its interest rate regulation. The Depository Institutions Deregulation Act of 1980, Pub. L. No. 96-221, Tit. II, 94 Stat. 142 (codified at 12 U.S.C. 3501-3509 (1982)), largely withdrew, over a six-year period, the direct regulation of interest rates on time deposits. That Act both eliminated the interest rate ceilings on all interest-bearing deposit accounts, which had been enforced by Federal Reserve Board Regulation Q and the FDIC, and permitted banks to pay

interest on checking deposits (NOW accounts) maintained by individuals or charitable organizations. 12 U.S.C. 1832; 12 C.F.R. 204.130.

Federal regulation of interest continues in several forms. First, federal law still prohibits the payment of interest on demand deposits maintained by businesses. 12 U.S.C. 371a, 1464(b)(1)(B), 1828(g).¹⁷ Second, a bank offering depositors above-market rates may be engaging in an unsafe banking practice, making it subject to a cease-and-desist order pursuant to the federal banking regulators' enforcement authority. 12 U.S.C. 1818(a) and (b). Third, the Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236, prohibits banks with capital below a designated level from paying above-market rates on pooled, brokered deposits. 12 U.S.C. 1831f(e).

The federal government has thus frequently regulated and limited the payment of interest to promote important public policy goals. In many of those instances, moreover, restrictions on the payment of interest have inured to the economic benefit of others, such as the depository institution that is permitted to enjoy the interest-generating capacity of funds in its accounts.

Given this overall framework, when respondents chose to provide money to their attorneys and to have it injected into the highly regulated banking system, they could have had no reasonable expectation either that they would receive interest on their nominal or short-term funds, or that statutes and regulations might not result in others benefitting economically from the presence of their funds in the banking system. Cf. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1006-1007 (1984) (Because "Monsanto chose

¹⁷ A bill was recently introduced in Congress that would allow interest to be paid on the demand accounts of businesses. H.R. 2323, 105th Cong., 1st Sess. (July 31, 1997).

to submit the requisite data in order to receive a registration, it can hardly argue that its reasonable investment-backed expectations are disturbed when [the agency] acts to use or disclose the data in a manner that was authorized by law at the time."); *Andrus v. Allard*, 444 U.S. 51, 66 (1979) ("[P]erhaps because of its very uncertainty, the interest in anticipated gains has traditionally been viewed as less compelling than other property-related interests.").¹⁸ Respondents could reasonably expect only to have their principal available to them upon demand and, at most, to retain any interest their individual funds actually generated, under existing law, in excess of administrative costs. IOLTA does not affect those interests. Cf. *Sperry*, 493 U.S. at 62 (governmental retention of percentage of monetary award that bears reasonable relationship to administrative costs is not a taking).

In sum, "[i]n the course of regulating commercial and other human affairs, Congress routinely creates burdens for some that directly benefit others." *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 223 (1986). But, "[g]iven the propriety of the governmental power to regulate, it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another." *Ibid.*; see also *id.* at 228 (O'Connor, J., concurring).

C. As A Government-Created Value, IOLTA Interest Is Not A Component Of Private Property Protected By The Fifth Amendment

The "private property" that is protected by the Just Compensation Clause does not include every potentially

¹⁸ See also *Tellis v. Godinez*, 5 F.3d 1314, 1317 (9th Cir. 1993) (Farris, J., dissenting) ("I would welcome a constitutional right to interest, as would others in the marketplace, but there is none."), cert. denied, 513 U.S. 945 (1994).

valuable use of property. In particular, the Fifth Amendment does not require compensation for value that the government creates through the application of its own resources or a consolidation of interests, especially if the individual owner could not reasonably develop that value on his own. Because IOLTA interest is the product of the government's pooling of funds, rather than of the earning capacity of the money in the hands of its individual owners, the interest that IOLTA generates is government-created value and thus is not "private property" within the meaning of the Fifth Amendment.

1. At its core, respondents' position claims as property the interest-generating power of all the clients' combined funds, rather than the interest-generating capacity of each individual client's holdings. In effect, respondents argue that the whole is greater than its parts: that while no right to accrue interest was taken from the individual clients, once combined into a pool, the property interests of the individual owners expanded and that combined power to accrue interest is what petitioners have taken. This Court's Fifth Amendment jurisprudence forecloses that argument.

Where a taking has occurred, the proper inquiry in ascertaining the amount of compensation due under the Fifth Amendment is "what has the owner lost, and not what has the taker gained." *United States v. Chandler-Dunbar Water Power Co.*, 229 U.S. 53, 76 (1913); see also *Olson v. United States*, 292 U.S. 246, 255 (1934) (The Fifth Amendment entitles a property owner to be "put in as good a position pecuniarily as if his property had not been taken. He must be made whole but is not entitled to more."). Here, respondents have lost nothing.

In *Boston Chamber of Commerce v. City of Boston*, 217 U.S. 189 (1910), the owners of three separate property interests (the fee, a mortgage on the fee, and an easement)

brought suit seeking compensation for the laying of a public street over their property. Rather than requesting payment for the value of their individual property losses, the owners sought compensation for the combined value of the property, which greatly exceeded the value of the distinct interests. *Id.* at 193. This Court held that the Fifth Amendment does not evaluate property interests as a whole when they are not held as a whole. *Id.* at 195 ("But the Constitution does not require a disregard of the mode of ownership * * *. It does not require a parcel of land to be valued as an unencumbered whole when it is not held as an unencumbered whole."). Rather, the Fifth Amendment "merely requires that an owner of property taken should be paid for what is taken from *him*." *Ibid.* (emphasis added).

Likewise, in *City of New York v. Sage*, 239 U.S. 57 (1915), the Court held that the compensation due for a lot taken to build a reservoir did not include the enhanced value of the property "due to its union with other lots." *Id.* at 61. Rather, the owner's loss must be measured by the property's value distinct from the power of the government to enhance value by combining properties: "The City is not to be made to pay for any part of what it has added to the land by thus uniting it with other lots, if that union would not have been practicable or have been attempted except by the intervention of eminent domain." *Ibid.*; see also *Powelson*, 319 U.S. at 274, 280-281, 285 (claimant not entitled to have value of his property increased by the possibility of its combination with other properties to create a hydroelectric project); *Olson*, 292 U.S. at 256 ("Value to the taker of a piece of land combined with other parcels for public use is not the measure of or a guide to the compensation to which the owner is entitled.").

Again, in *United States v. Fuller*, 409 U.S. 488 (1973), the owner of property taken by the government, which was

near federal land the owner leased under the Taylor Grazing Act, claimed that the value of his land should be measured by its potential use "in conjunction with" the grazing areas. *Id.* at 490. This Court held, however, that the government may not be charged under the Fifth Amendment "for elements of value that the Government has created." *Id.* at 492; see also *id.* at 499 (Powell, J., dissenting) (agreeing that "compensation need not be afforded for an increase in market value stemming from the very Government undertaking which led to the condemnation"); *United States v. Cors*, 337 U.S. 325, 334 (1949) ("That is a value which the government itself created and hence in fairness should not be required to pay."); *United States v. Causby*, 328 U.S. 256, 262 n.7 (1946) ("The courts have held that the deprivation of the former owner rather than the accretion of a right or interest to the sovereign constitutes the taking.").¹⁹

This is not to say that a property owner may never claim as a compensable property interest the value of his land combined with other properties. But he may do so only "if the union of properties necessary is so practicable that the possibility would affect the market price." *Sage*, 239 U.S. at 61. The claimant must show, in other words, "a reasonable probability of the [property] in question being

¹⁹ Federal regulation of interest payments sometimes has turned upon the amount of money deposited. See, e.g., 12 C.F.R. 217.7 (1979). Respondents' argument would seem to claim as their private property the dollar amount of the difference between what the government permitted the bank to pay on accounts with higher principals and what the government permitted the bank to pay on their individual funds, because their funds, while individually incapable of generating such interest, could have earned it when pooled with the funds of others. Such convoluted claims are foreclosed because, under the logic of this Court's jurisprudence, the Fifth Amendment's definition of "private property" turns upon the presently practicable uses of property *by the owner*, rather than upon the anticipated use of property by others.

combined with other[s] * * * in the reasonably near future." *Powelson*, 319 U.S. at 275-276; see also *Olson*, 292 U.S. at 256.

Respondents cannot show that the property value they claim—the ability to combine with other clients' money to generate interest—could have been brought to fruition through their private efforts in the near future. To the contrary, Texas's IOLTA program is triggered only if the attorney concludes that pooling his or her clients' funds to earn interest for them is not economically feasible. IOLTA Rule 6; Texas Bar Rules, Art. XI, § 5(B); see also Pet. App. 24a n.2; Pet. Reply 2 n.1. Further, respondents have not shown that their attorneys or the attorneys' other clients wish to join them in this endeavor. "Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable," provide no basis for relief under the Just Compensation Clause, "for that would be to allow mere speculation and conjecture to become a guide for the ascertainment of value—a thing to be condemned in business transactions as well as in judicial ascertainment of truth." *Olson*, 292 U.S. at 257. Because the pooling of short-term and nominal client funds to generate interest is practicable only through an exercise of governmental power, respondents may not claim as their private property the economic value created by the IOLTA program. *United States v. Twin City Power Co.*, 350 U.S. 222, 228 (1956) ("What the Government can grant or withhold and exploit for its own benefit has a value that is peculiar to it and that no other user enjoys," and the government's generation of such value triggers no compensable property right in individuals.).²⁰

²⁰ See also *United States v. Miller*, 317 U.S. 369, 375 (1943) (Fifth Amendment does not recognize as a compensable property interest the

In sum, respondents' claim of a property right to interest created through the IOLTA program must fail because it focuses on the interest-generating value gained by the government through the IOLTA program, rather than on any interest-generating capacity lost by the clients. Because "[t]hese additional values represent * * * no actual loss" to respondents, there "would be no justice in paying for a loss suffered by no one in fact." *Chandler-Dunbar*, 229 U.S. at 76.²¹

"special value" of property to the government); *Chandler-Dunbar*, 229 U.S. at 80 ("That the property may have to the public a greater value than its fair market value affords no just criterion for estimating what the owner should receive.").

²¹ Respondents' alternative characterization of their property claim as a right to the equitable or beneficial interest in the trust account created by the lawyer, J.A. 11, 15, adds nothing to the case. The beneficial or equitable interest created by the individual clients' trust is zero. There are, of course, no proceeds from the trust at the time of its creation. See I A. Scott & W. Fratcher, *The Law of Trusts* § 86 ("The mere fact that he hopes and expects to acquire the property in the future does not give him any interest of which he can be trustee, or of which he can make another trustee, before he acquires it."), § 86.4 ("An interest that has not come into existence cannot be held in trust.") (4th ed. 1987). Nor do respondents have any legitimate expectation that costs reasonably commensurate with the administrative expense of managing their money will not be withheld. IIA Scott & Fratcher, *supra*, § 182 (trustee is under a duty only to pay "net income, after deducting from the gross income the expenses properly incurred in the administration of the trust"); III Scott & Fratcher, *supra*, § 188.5. As with their interest claim, respondents are attempting to claim as their own "private property" the proceeds of a pool of funds created by the government. Those proceeds are made possible only by the additional presence of other people's money, over which principles of trust law give respondents no right of control. IA Scott & Fratcher, *supra*, § 86.4; see also *id.* § 75. Furthermore, respondents have not claimed that they have an ordinary trust relationship with their attorney regarding their funds. Instead, the relationship on which they rely is established and defined by the State's ethical rules governing members

2. While the foregoing cases primarily concerned the compensation prong of the Just Compensation Clause, their delineation of the types of property values protected by the Fifth Amendment against being taken applies with equal force to the Clause's definition of "private property." Indeed, it would make little sense to read "private property" as embracing an entire class of constitutionally protected interests (*i.e.*, value separately created or enjoyed by the government) for which the Just Compensation Clause will supply no remedy in the event of a deprivation. The animating purpose of the Just Compensation Clause, after all, is not to limit governmental interference with property, "but rather to secure *compensation*" when a taking occurs. *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 315 (1987); see also *Suitum v. Tahoe Regional Planning Agency*, 117 S. Ct. 1659, 1665 (1997); *Williamson County Regional Planning Comm'n v. Hamilton Bank of Johnson City*, 473 U.S. 172, 194 n.13 (1985) ("no constitutional violation occurs until just compensation has been denied"). The remedy provided by the Just Compensation Clause, moreover, is intended to provide the owner "the full and perfect equivalent" for the property taken. *United States v. Miller*, 317 U.S. 369, 373 (1943); *Seaboard Air Line Ry. v. United States*, 261 U.S. 299, 304 (1923) (same); see also *PruneYard Shopping Ctr.*, 447 U.S. at 82 n.6. The concept of just compensation "is comprehensive and in-

of the bar. Nothing in that regulatory framework empowers individual clients to control the proceeds of the IOLTA pool of funds. See *Massachusetts Bar Found.*, 993 F.2d at 974. And the focus of the attorney's ethical obligation is on safeguarding the money, not investing it. Formal Op. 348, 68 A.B.A. J. at 1503; see also IIA Scott & Fratcher, *supra*, §§ 180, 181.

cludes all elements" of property value taken. *Jacobs v. United States*, 290 U.S. 13, 17 (1933).²²

This Court, in fact, has previously recognized the nexus between the Clause's definitions of "property" and of "just compensation." In *First English Evangelical*, the Court held that a taking of property rights "necessarily implicates the constitutional obligation to pay just compensation." 482 U.S. at 315 (internal quotation marks omitted). Further, in *Powelson*, the Court expressly intertwined its analyses of the existence of a property right and the scope of compensation required by the Fifth Amendment. 319 U.S. at 279-283, 285; see also *United States v. Rands*, 389 U.S. 121, 126 (1967); *Twin City Power*, 350 U.S. at 227-228. Moreover, the very concept of "reasonable expectations" that this Court employs to identify property rights (see, e.g., *Penn Central*, 438 U.S. at 125) precludes recognition of property values that the individual owners cannot practicably or reasonably realize themselves. Accordingly, the definition of "private property" adopted in this case must take account of the limitations on value recognized in this Court's compensation precedents, and therefore should not extend to interest that government alone can extract from funds within the banking system.

3. In holding that interest on an IOLTA account is private property, the court of appeals found significant the sequence in which bank fees and interest happened to be recorded. Pet. App. 13a. Because the interest was as-

²² Just compensation, however, is calculated in objective, rather than subjective, terms. *United States v. 564.54 Acres of Land*, 441 U.S. 506, 511 (1979). For that reason, respondents' philosophical objections to the purposes served by the governmental regulation have no bearing on the scope of the Constitution's protection. *Id.* at 511-512. Given the fungible character of money, this principle should apply with particular force to funds that, through deposit in a bank, have been injected by the owner into the national economic stream.

signed before the bank fees were deducted, the court of appeals concluded that "a property interest attaches the moment that the interest accrues," *ibid.*, even if the service fees deducted the next moment equaled or exceeded the interest gained.

The court of appeals' focus on the fleeting attachment of unattainable interest conflicts with this Court's repeated admonitions that the Just Compensation Clause is concerned with economically viable and productive uses of property, rather than with hypothesized or impalpable interests. See *Roth*, 408 U.S. at 577 ("To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it."); cf. *Hooker v. Burr*, 194 U.S. 415, 419 (1904) ("If not injured to the extent of a penny thereby, his abstract rights are unimportant.").

In *Lucas*, this Court characterized as a taking of private property a regulation that deprived the owner of all "economically beneficial or productive use of [the property]." 505 U.S. at 1015. Similarly, in *Dolan v. City of Tigard*, 512 U.S. 374 (1994), the Court reaffirmed that a regulation does not effect a taking if it does not deny an owner "economically viable use" of his or her property. *Id.* at 385 (quoting *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980)); see also *Yee*, 503 U.S. at 523 (taking analyzed in terms of whether the government deprives the owner of "the economic use of the property"); *United States v. Reynolds*, 397 U.S. 14, 16 (1970) ("In enforcing the constitutional mandate, the Court at an early date adopted the concept of market value."); *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 414 (1922) ("What makes the right to mine coal valuable is that it can be exercised with profit."). Indeed, it is only "reasonable expectations" that may give rise to a property claim under the Fifth Amendment. *Penn Central*, 438 U.S. at 125. Recognizing a property

right in interest that can never actually be realized, as the court of appeals did, would take the "reasonable" out of "reasonable expectations."²³

D. *Webb's Fabulous Pharmacies, Inc. v. Beckwith* Does Not Render IOLTA Programs Unconstitutional

The determination that interest earned on IOLTA accounts is not the private property of respondents is fully consistent with *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980). In *Webb's*, this Court held that the more than \$100,000 in interest earned on an interpleaded fund belonged to the owners of the principal, and could not be diverted to the county treasury. *Id.* at 164. This Court explained that "[t]he earnings of a fund are incidents of ownership of the fund itself and are

²³ The court of appeals' discussion of the import of the Internal Revenue Service's Revenue Ruling 81-209 (Pet. App. 14a-15a) misunderstands the limited purpose of that ruling. The ruling discusses only whether IOLTA interest could be considered taxable income of the clients. Rev. Rul. 81-209, 1981-2 C.B. 16. It does not purport to address whether the interest is property, within the meaning of the Fifth Amendment. Furthermore, the income tax is imposed on "income from whatever source derived," not property. 26 U.S.C. 61(a); see also U.S. Const. Amend XVI. If it were a property tax, it would have to be apportioned among the States. U.S. Const. Art. I, § 9, Cl. 4; see also *Brushaber v. Union Pacific R.R.*, 240 U.S. 1, 12-19 (1916). The definitions of "income" and "property" are not coextensive, moreover. A taxpayer may derive income from a transaction in which he receives no property. *E.g.*, 26 U.S.C. 132(f)(2)(B); *Hillsboro Nat'l Bank v. Commissioner*, 460 U.S. 370, 377-385 (1983); *United States v. Kirby Lumber Co.*, 284 U.S. 1, 3 (1931); *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716, 729-731 (1929). See also *Cone*, 819 F.2d at 1007 n.8. The court's focus on the particular order in which the banking transactions occurred is also in tension with this Court's recognition in *Sperry* that "money is fungible" and that "[n]o special constitutional importance attaches to the fact that the Government deducted its charge directly from the award rather than requiring *Sperry* to pay it separately." 493 U.S. at 62 n.9.

property just as the fund itself is property." *Ibid.* Because the interest earned in that case far exceeded the administrative costs and fees associated with its generation, *id.* at 159-160, this Court did not address or question the State's power to retain interest reasonably commensurate to the cost of servicing the account. *Id.* at 160, 165. Rather, the Court carefully confined its holding to

the narrow circumstances of this case—where there is a separate and distinct state statute authorizing a clerk's fee "for services rendered" based upon the amount of principal deposited; where the deposited fund itself concededly is private; and where the deposit in the court's registry is required by state statute in order for the depositor to avail itself of statutory protection from claims of creditors and others.

Id. at 164.

The present case differs from *Webb's* in three significant respects. First, *Webb's* did not involve government-created value. The *Webb's* claimants' principal was capable, under existing interest rules, of generating realizable interest without any government intervention or alteration of the underlying condition of the property. The interest-generating principal was "concededly * * * private." 449 U.S. at 164. Here, by contrast, the fund that actually generates realizable interest is a public creation. In the absence of the governmental program pooling the funds, no interest could or would be realized. See *Twin City Power*, 350 U.S. at 228 (no compensable property right exists where "[t]he right has value or is an empty one dependent solely on the Government").

Second, any interest actually earned by respondents' funds would not, by definition, exceed the administrative costs of servicing the account and allocating the interest to them individually. *Webb's* did not suggest that accrued interest that falls below a reasonable estimation of the

costs and fees associated with managing an account must, as a matter of constitutional law, be regarded as the private property of the beneficial owners of the principal. *Webb's* dealt only with interest that was actually realizable under state law, separate and apart from appropriate service charges. 449 U.S. at 161, 162, 164; see also *Sperry*, 493 U.S. at 62 & n.8; cf. *Colorado Springs Prod. Credit Ass'n v. Farm Credit Admin.*, 967 F.2d 648, 657-658 (D.C. Cir. 1992).

Third, while state law governs what happens to the funds when a client provides money to an attorney, no client is "required by state statute" to give money to his attorney as a precondition for availing himself of the protections of the legal system. *Webb's*, 449 U.S. at 164. Whether or not funds will come into the possession of an attorney is generally a matter of contractual agreement between client and counsel.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

WALTER DELLINGER
Acting Solicitor General
FRANK W. HUNGER
LOIS J. SCHIFFER
Assistant Attorneys General
EDWIN S. KNEEDLER
Deputy Solicitor General
PATRICIA A. MILLETT
Assistant to the Solicitor General
ROBERT KLARQUIST
TIMOTHY DOWLING
JARED A. GOLDSTEIN
Attorneys

10

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1996

HON. THOMAS R. PHILLIPS, et al.,

Petitioners,

vs.

WASHINGTON LEGAL FOUNDATION, et al.,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF OF *AMICI CURIAE* IN SUPPORT OF
THE PETITIONERS

Arthur J. England, Jr., Esq.
Greenberg, Traurig,
Hoffman, Lipoff, Rosen
& Quentel, P.A.
1221 Brickell Avenue
Miami, Florida 33131
305-579-0605

Peter M. Siegel, Esq. *
Randall C. Berg, Jr., Esq.
JoNel Newman, Esq.
Florida Justice Institute, Inc.
Suite 2870
200 South Biscayne Blvd.
Miami, Florida 33131-2310
305-358-2081

Attorneys for *Amici Curiae*

August 25, 1997

* Counsel to be served,
Member of the Bar of the Court

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SUPREME COURT OF THE UNITED STATES
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HON. THOMAS R. PHILLIPS, et al.,

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Respondents.

**BRIEF OF AMICI CURIAE IN SUPPORT OF
THE PETITIONERS**

INTEREST OF AMICI CURIAE

The Texas Equal Access to Justice Program¹, like the 50 other similar programs throughout the country (herein collectively referred to as "IOLTA" programs) operates on the premise that nominal sums of money, or short term

¹Consents from all parties for the filing of this brief have been filed with the Clerk of this Court.

Counsel for a party did not author this brief in whole or in part. No person or entity, other than the Amicus Curiae, made a monetary contribution to the preparation and submission of this brief.

deposits, held by attorneys on behalf of their clients, constitute an unused economic resource which may be mobilized to generate income to improve the administration of justice and delivery of legal services to the poor.

The IOLTA programs authorize attorneys to pool nominal or short term client funds, which before IOLTA were required by the applicable rules of professional conduct, and by then-existing banking law restrictions, to be deposited in interest-free checking (demand) accounts, and deposit them in negotiable order of withdrawal ("NOW ") or similar accounts. The interest generated only because of the aggregation of the funds is then used to support legal services to the poor and other law-related public purposes. The hundreds of millions of dollars which have been raised in this fashion, at no cost to any client, provide an irreplaceable source of funding for civil legal aid to the poor.

The Fifth Circuit's decision, if upheld, would destroy a program which has justifiably deserved the plaudits it has received from the bench, the bar, the media, and the public. The eighty-four (84) *amici curiae*, whose names are set out in the Addendum to this Brief, are all organizations vitally interested in the continued growth and success of IOLTA programs as a mechanism for bringing the concept of equal justice under the law a step closer to reality. The forty (40) participating state bar associations have all been instrumental in creating IOLTA programs in their respective states. The forty (40) participating IOLTA administering agencies all collect IOLTA generated funds and distribute them to providers of legal services to the poor, and for other worthy law-related public purposes. The other *amici curiae* are all organizations vitally interested in furthering the principle of equal justice under law for all.

Each participating *amicus* believes that IOLTA is critically important to ensuring that those in need of legal

services do not go without. Their participation attests to the nationwide acceptance of the IOLTA concept by a broadly representative sample of the legal profession. Firmly believing that IOLTA programs are in the best tradition of the legal profession, *amici curiae* fully support the Justices of the Texas Supreme Court and the Texas Equal Access to Justice Foundation in urging that the decision of the Fifth Circuit be reversed.

ARGUMENT

INTEREST ON LAWYER TRUST ACCOUNT PROGRAMS, WHICH DO NOT INJURE CLIENTS, EVEN TO THE EXTENT OF A SINGLE PENNY, DO NOT TAKE ANY PROPERTY TO WHICH ANY CLIENT HAS A LEGITIMATE CLAIM OF ENTITLEMENT

A. The IOLTA Premise

Attorneys must "hold property of clients or third parties that is in a lawyer's possession in connection with a representation separate from a lawyer's own property." Rule 1.15, Model Rules of Professional Conduct (ABA 1995). Prior to IOLTA, to meet these responsibilities attorneys held most client funds in commingled, non-interest bearing demand (checking) accounts, usually called attorney trust accounts. Generally, without regard to the amount of the funds, or the length of time the funds were expected to be held by the attorney, the client was deprived of the ability to earn interest as a result of the combination of the mandate that an attorney place the funds in an account which would permit the immediate return of the funds on request, *i.e.*, a demand account, and banking law restrictions which barred payment of interest on demand accounts.

With IOLTA, nominal funds or funds expected to be held for a short period of time, that is, funds which on their own, because of very real banking and economic constraints are not capable of producing income net of expenses, are placed in commingled, interest bearing NOW accounts, and the interest generated, after bank service charges, is used to fund legal aid programs, pro bono delivery systems, and other, law-related public service projects. As in Texas, the general process is for the attorney's bank, after deducting service charges, to remit the net interest earned directly to an IOLTA administering agency, such as the Texas Equal Access to Justice Program, which in turn makes grants to support administration of justice projects, the delivery of pro bono pro services, and legal aid programs.

To understand IOLTA, and why it does not take the property of any client, it is necessary to examine (1) the rules of professional conduct which in all states compel attorneys to place client and third party funds in accounts separate and apart from accounts containing funds belonging to the attorney, and to return the funds immediately upon request, (2) the regulation of banking, and of the ability of a depositor to earn interest, and (3) the economic realities of opening, administering, and disbursing funds which have been deposited in an interest-bearing account.

IOLTA establishes a unique method of financing civil legal aid to the poor by taking advantage of these factors and harnessing funds that, before adoption of the program, were neither used nor capable of being used to produce income for a client. Unlike the First and Eleventh Circuits, and the 45 state supreme courts which have authorized and adopted similar programs, the Fifth Circuit refused to recognize that IOLTA combines lawyer trust account mandates, banking law restrictions, and economic realities, to produce income where, previously, there was no income.

IOLTA is simplicity itself. Attorneys routinely receive client and third-party funds which they must hold in their attorney trust accounts. If the funds are large in amount or expected to be held for a long period of time, IOLTA rules in all the states preclude the placing of such potentially productive funds in an IOLTA account. For productive funds, the attorney's ethical duty is to consult with the client and determine where to place the funds so that the client may benefit from the earning power of the funds.² IOLTA does not change this time-honored practice. To the contrary, it reinforces the principle that where client funds are capable of earning income net of expenses, the attorney should place the funds in an interest bearing account for the benefit of the client. ABA *Annotated Model Rules of Professional Conduct* 236 (3d ed. 1996). See also A.B.A. Formal Opinion 348, 68 ABA J. 1502 (1982); *Petition of Minnesota State Bar Association*, 332 N.W.2d 151, 157 (Minn. 1982).

Often, however, lawyers hold funds in amounts which are very small or expected to be held for a very short period of time. As a matter of economic reality, it is simply impossible to invest such funds productively for the benefit of the client. That is because bank service charges, as well as bank rules limiting the payment of interest on accounts not open as of the end of a month, or for a specific time period, all preclude the possibility of earning interest on many client trust account deposits. Likewise, the wide range of costs that a lawyer would incur, including (1) the time to obtain tax identification information, (2) the time to determine whether investment is warranted, (3) the time to open a separate, income producing account, (4) law firm bookkeeping on a periodic basis, (5) preparation of tax reporting forms, and (6)

²Absent specific and informed consent, the attorney may not retain the interest earned on client funds. *The Florida Bar v. Dancu*, 490 So.2d 40 (Fla. 1986).

the time required to close a separate, income producing account, all preclude the earning of net income on the funds of many clients. See A.B.A. Task Force and Advisory Board on Interest on Lawyer Trust Accounts, *Report to the Board of Governors*, 22-24 (July 1982).

With IOLTA, all economically unproductive client funds are pooled by the attorney in an interest-bearing NOW account. Interest net of expenses is earned only because of the pooling. As Respondents Mazzone and Summers acknowledged before the district court, they lose nothing because of IOLTA.

A few brief examples of the nonproductive funds that are placed in an attorney's IOLTA trust account will demonstrate why the client suffers no injury, not even to the extent of a penny.

1. **Cost Deposits.** A client involved in litigation is often required to provide costs, such as filing and service of process fees, in advance of actual disbursement. In some, but not all states, those funds must be placed in the lawyer's trust account. In entrusting funds to the lawyer for the payment of costs, the client has no expectation of having the funds returned (although excess advances will be returned) nor any expectation of earning interest. The facts in *Cone v. State Bar*, 819 F.2d 1002 (11th Cir.), *cert. denied*, 487 U.S. 917 (1987), are typical. The client gave her attorneys a \$100 cost deposit. At the time of receipt, the small size of the deposit, as well as the expectation that the funds would be promptly disbursed, did not justify an effort to invest the funds. After disbursement, the small amount left over, \$13.75, also did not justify investment. Moreover, it is clear that, as a practical matter, \$13.75 is inherently incapable of being put to productive use for an individual. The approximately 3¢ per month in earnings on \$13.75, at current NOW

account rates,³ would not offset bank service charges, let alone the costs incurred by an attorney to administer a separate interest-bearing account.

2. **Real Estate Escrows.** An attorney representing the seller of a small piece of property receives \$500 to be held in escrow. At closing, which may take place anywhere from thirty to sixty days later, the deposit is applied to the sales price. If closing does not take place, depending on the sales contract and other factors, either the buyer or seller may be entitled to the deposit. The gross interest earned by the deposit, \$1.42 per month, would not justify the time and expense required to set up a separate NOW account.

3. **Real Estate Closings.** In a similar fashion, an attorney may receive the funds necessary for a residential real estate closing by wire a day in advance, thereby producing a one day accrual of interest. Or, the closing may be unexpectedly delayed for a day or two to clear last minute problems. There is no practical way to make such short term funds productive for the client. However, when placed in an IOLTA account, interest can be earned on funds held for periods as short as a day or two.

4. **Personal Injury Settlements.** Settlements come from insurance companies in the form of checks or drafts. Banks customarily indicate a time period in which it is safe to assume that the insurance company has accepted the draft or the check has cleared, but in fact the credit to the lawyer's trust account may occur sooner. For example, assume \$50,000 is credited to an attorney's trust account on a

³Rates vary from bank to bank and place to place. The rate used here, 2.5%, is greater than generally available. For example, state-wide in Florida, the average rate paid on IOLTA NOW accounts is only 1.43%.

Monday. The lawyer's trust account check is mailed to the client that day. It is received and deposited by the client on Wednesday. It clears the lawyer's bank on Friday. If a separate account were opened to accomplish this receipt and disbursement, no interest would be earned because of the short period of time during which the account was active. However, when the funds are placed into an IOLTA account for five days, they can produce income of \$17.12. Does the client have any expectation of receiving interest earned by the settlement amount during these few days? Clearly not. Indeed, there is no practical way to open a separate account to capture the \$17.12 that can be earned by the IOLTA account.

IOLTA programs operate according to three models: (1) voluntary (the attorney decides whether to participate), (2) opt-out (the attorney must specifically advise the state IOLTA agency that the attorney will not participate), or (3) mandatory (all attorneys must participate).⁴ The different models affect the attorney, but not the client. In all cases, if the attorney participates, the attorney will place all nominal or short term deposits in the attorney's IOLTA account. Client choice is not possible because of the potential tax consequences resulting from the assignment of income doctrine. *See Matter of Interest on Trust Accounts*, 402 So.2d 389, 390-91 (Fla. 1981). However, IOLTA does not alter in any way the attorney client relationship. Nor does it compel any client to give, or any attorney to accept, funds for deposit in an IOLTA account.

While there are minor variations from state to state, the essential premise remains constant: that nominal or short

⁴There are 4 voluntary programs, 20 opt-out programs, and 27 mandatory programs. ABA/BNA *Lawyers' Manual on Professional Conduct* § 45:202-05 (1997).

term client funds, which on their own are incapable of producing income net of expenses, can be aggregated to produce income where, in the absence of IOLTA, there would be no income. In every state, attorneys must in good faith determine which client funds should be placed at interest for the benefit of the client and which client funds should be placed in an IOLTA account. Rule 5-1.1(e)(7), Rules Regulating The Florida Bar (1997), is typical. It provides that:

Determination of Nominal or Short-Term Funds.

The lawyer shall exercise good faith judgment in determining upon receipt whether the funds of a client or third person are nominal or short term. In the exercise of this good faith judgment, the lawyer shall consider such factors as:

- (A) the amount of a client's or third person's funds to be held by the lawyer or law firm;
- (B) the period of time such funds are expected to be held;
- (C) the likelihood of delay in the relevant transaction(s) or proceeding(s);
- (D) the cost to the lawyer or law firm of establishing and maintaining an interest-bearing account or other appropriate investment for the benefit of the client or third person; and
- (E) minimum balance requirements and/or service charges or fees imposed by the financial institution.

Several states have incorporated a benchmark into their IOLTA rule; if the funds at the time of deposit are expected

to produce more than \$50.00 in interest, they cannot be deemed nominal or short term.⁵ See, e.g., Opinion R-7, Committee on Professional and Judicial Ethics of the State Bar of Michigan, ABA/BNA, *Lawyers' Manual on Professional Conduct* § 904:4707 (1990); Md. Code Ann., Bus. Occ. & Prof. § 10-303(b) (1996). See also, Machen, *I-O-L-T-A "What Is It/How Does It Work"?*, 1983 Md. B.J. 6, 9.

Other states have a provision in their IOLTA rule which provides, as does Delaware's, that: "A lawyer should review at reasonable intervals whether changed circumstances require further action respecting the deposit of client funds." DR9-102(C)(4), Delaware Rules of Professional Conduct. If circumstances have changed, the lawyer should remove the funds from the IOLTA account and place them at interest for the benefit of the client. Opinion 87-2, Ethics Committee of the Massachusetts Bar Association, ABA/BNA, *Lawyers' Manual on Professional Conduct* § 901:4602 (1987).⁶

IOLTA's mechanism for generating income to provide critically important public services, while fully protecting the legitimate expectations of clients to benefit from funds capable of producing income net of expenses, accounts for IOLTA's nationwide acceptance. While the public benefits, clients suffer no loss because their nominal or short term deposits produce income net of expenses only because they are pooled in an IOLTA account. And, as the legal profes-

⁵For example, a \$1,000 deposit for costs will require two years to earn the benchmark amount.

⁶To correct errors, most states have provisions for the IOLTA administering agency to refund interest when it is determined that the funds should have been placed at interest for the benefit of the client. See, e.g., DR9-102(C)(4), Oklahoma Rules of Professional Conduct.

sion fully recognizes, IOLTA is a vital component for meeting the critical need for additional resources to improve the justice system.

B. IOLTA's Nationwide Acceptance

Today, all fifty states and the District of Columbia have adopted IOLTA programs. ABA/BNA, *Lawyers' Manual on Professional Conduct* § 45:201 (1997). Collectively, the programs have raised hundreds of millions of dollars, primarily to support the provision of legal aid to the poor. With the cuts in federally funded legal services programs, IOLTA has become even more vital; it has become the second largest source of funds for legal aid programs.

The IOLTA concept originated in Australia. It then spread to Canada, where some of the IOLTA generated funds were first used for legal aid. England & Carlisle, *History of Interest on Trust Accounts Program*, 56 Fla. B.J. 101 (1982). Florida was the first state to authorize an IOLTA program, *In re Interest on Trust Accounts*, 356 So.2d 799 (Fla. 1978). After NOW accounts became available,⁷ and tax issues were resolved,⁸ implementation commenced in 1981. *Matter of Interest on Trust Accounts, supra*, 402 So.2d 389.

⁷NOW accounts were authorized by The Consumer Checking Account Equity Act of 1980, Title III of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 303, 94 Stat. 146 (1980), codified at 12 U.S.C. § 1832(a) (1994).

⁸Revenue Ruling 81-209, 1981-2 C.B. 16, permitted the Florida IOLTA program to go forward without adverse tax consequences to either client or attorney so long as all nominal or short term client funds were placed into the IOLTA account.

In a remarkably few years, every state and the District of Columbia adopted an IOLTA program. The highest courts of seven states, in adopting IOLTA programs for their respective states, have expressly held that IOLTA does not violate the Fifth Amendment. *Matter of Interest on Trust Accounts*, *supra*, 402 So.2d 389; *Petition of Minnesota State Bar Association*, *supra*, 332 N.W.2d 151; *Petition of New Hampshire Bar Association*, 122 N.H. 971, 453 A.2d 1258 (1982); *Matter of Interest on Lawyers' Trust Acc.*, 672 P.2d 406 (Utah 1983); *In the Matter of the Adoption of Amendments to CPR DR 9-102 IOLTA*, 102 Wash.2d 1101 (1984); *In the Matter of Interest on Lawyers' Trust Accounts*, 283 Ark. 252, 675 S.W.2d 355 (1984), *rev'g*, 279 Ark. 84, 648 S.W.2d 480 (1983); *Petition by Massachusetts Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985).

In addition, like Texas, thirty-seven other state supreme courts and the District of Columbia Court of Appeals have adopted IOLTA programs without formal opinion, although in each jurisdiction the Fifth Amendment was raised as a barrier to adoption of the program.⁹ IOLTA programs have been established by legislation in five states, California, Connecticut, Maryland, New York and Ohio. The American

⁹The Supreme Courts of Arkansas, Maine, Michigan and North Carolina initially rejected but subsequently approved IOLTA programs. The Supreme Court of Indiana initially refused to adopt an IOLTA program, primarily on the grounds that it was unethical. *Matter of Indiana State Bar*, 550 N.E.2d 311 (Ind. 1990). Later, it struck down legislation adopting an IOLTA program on separation of powers grounds. *Matter of Public Law No. 154-1990*, 561 N.E.2d 791 (Ind. 1990). Thereafter, in October, 1993, the Indiana Supreme Court, acting pursuant to its rulemaking power, authorized an IOLTA program, which is currently in the implementation stage.

Bar Association has endorsed the ethical propriety of IOLTA programs. A.B.A. Formal Opinion 348, 68 ABA J. 1502 (1982).

Prior to the ruling of the Fifth Circuit, no court in an adversary proceeding had ever rejected an IOLTA program. In an identical challenge brought by the Washington Legal Foundation, Massachusetts' IOLTA program was upheld. *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962 (1st Cir. 1993). The Florida program was upheld in *Cone v. State Bar*, *supra*, 819 F.2d 1002. The California IOLTA program was upheld in *Carroll v. State Bar of California*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (4th Dist. 1984), *cert. denied sub nom. Chapman v. State Bar of California*, 474 U.S. 848 (1985). In *Ronwin v. Supreme Court of Iowa*, (No. 84-1641), *cert. denied*, 471 U.S. 1101 (1985), this Court refused to review the Iowa Supreme Court's rulemaking adoption of an IOLTA program.

The decision of the Fifth Circuit stands in sharp contrast to the literally hundreds of judges from 45 states, the District of Columbia, and the First and Eleventh Circuits, who have concluded that the Fifth Amendment is not a bar to implementation of an IOLTA program.

C. Absence of a Property Interest

The critical constitutional question raised by IOLTA programs is whether using clients' monies, which lawyers hold in aggregated trust accounts, to produce income for public services, constitutes a taking of property without just compensation contrary to the dictates of the Fifth Amendment. Those who object to IOLTA programs rely on *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) for the over-broad proposition that the owner of a fund possesses a vested property right to the earnings of that fund

in any and all circumstances, notwithstanding the economic realities which, as Respondents admit, preclude the earning of any income net of expenses on funds deposited in an IOLTA account. *Amici curiae*, on the other hand, submit that no property is taken because IOLTA creates income which would not otherwise accrue to the benefit of any client.

In deciding that IOLTA offends the Fifth Amendment, the Fifth Circuit did not meaningfully address the issue of whether the Respondents have any property interest in the income created only because of the IOLTA program. It failed to apply the holding of *Board of Regents of State Colleges v. Roth*, 408 U.S. 564 (1972), that in order to have a property interest, the claimant must be able to identify a legitimate claim of entitlement. It certainly overlooked the inherent finding of the Texas Supreme Court when it adopted the Texas Equal Access to Justice Program that no client had a property interest in the income generated because only the aggregation of nominal and short term deposits could produce income net of expenses.¹⁰ And, in a similar fashion, it overlooked the decisions of the 43 other state supreme courts which concluded, either implicitly or explicitly, that no client has a legitimate claim of entitlement to the interest generated only because of the IOLTA program.

A claim of entitlement to all interest earned on a bank account does not enjoy a great deal of historical support. At common law it was unlawful to recover interest on money loaned. *National Bank v. Mechanics' Nat'l Bank*, 94 U.S. (4 Otto.) 437 (1877). The general rule is that the "right to recover interest upon the loan or forbearance of money" is

¹⁰The Fifth Circuit ignored the well-established rule of law that a state court's interpretation of its own law is binding on the federal courts. *New York v. Ferber*, 458 U.S. 747, 767 (1982).

purely statutory. *Frazer, Executor v. Boss*, 66 Ind. 1 (1879). Thus, absent statute or contract, banks have no obligation to pay interest on deposits. *Jones v. Mallory*, 22 Conn. 386 (1853).¹¹

Early American banks were established for the purpose of providing "safe depositories for the funds of capitalists."¹² Beginning in 1781 banks in the modern sense were established in ever increasing numbers.¹³ Still, the suggestion in 1810 that the First Bank of the United States pay interest on government deposits was considered a radical departure from accepted banking practices.¹⁴ Even as late as 1834, it was thought the purpose of making a bank deposit was solely for safekeeping.¹⁵

As the banking industry evolved, competition for deposits grew. To attract new deposits, the payment of interest on demand deposits became widespread.¹⁶ Due to the

¹¹For a more extensive discussion, see Siegel, *Interest on Lawyers' Trust Account Programs: Do They "Take" "Property" of the Client?*, 36 U. Fla. L. Rev. 674, 681-91 (1984).

¹²1 F. Redlich, *The Molding of American Banking: Men and Ideas* 13-14 (Johnson Reprint 1968).

¹³B. Hammond, *Banks and Politics in America: From the Revolution to the Civil War* 71-72 (1957).

¹⁴1 F. Redlich, *supra*, at 14 n. 103.

¹⁵*Id.* at 13 n. 99.

¹⁶*Id.* Vol. 2, at 6. Before 1840, it was unusual for interest to be paid on demand deposits of individuals, (continued...)

financial panic of 1857, forty-two New York City banks agreed among themselves to cease paying interest, soon followed by banks elsewhere.¹⁷ However, the pressure of new competition after the Civil War resulted in the resumption of interest payments.¹⁸ By 1884, the payment of interest on demand deposits had become almost universal among banks.¹⁹

The bank failures of the Great Depression resulted in a complete overhaul of banking law and far more extensive federal regulation. Section 11(b) of the Banking Act of 1933 barred commercial banks from paying interest on demand deposits and authorized the Federal Reserve Board to limit, by regulation, the rate of interest payable on time and savings deposits.²⁰ Corporations could only use time deposits

¹⁶(...continued)

although interest was often paid on demand deposits of other banks, corporations, and governmental entities. *Id.* at 53.

¹⁷1 F. Redlich, *supra*, at 7. By 1860, virtually all of New York City banks had stopped paying interest on deposits. A. Cox, *Regulation of Interest Rates on Bank Deposits* 3 (1966).

¹⁸*Id.*

¹⁹J. Knox, *A History of Banking in the United States* 187 (1900).

²⁰Banking Act of 1933, ch. 89, § 11(b), Pub. L. No. 66, 48 Stat. 181 (1933). That section provided in relevant part that: "No member bank shall directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand." In *Steingut v. Guaranty Trust Co.*, 161 F.2d 571 (2d Cir.), *cert. denied*, 332 U.S. 753, 807 (continued...)

to earn interest, but those funds were not available on demand. Did the federally imposed banking restrictions work a taking by effecting a transfer of the earning power of funds which — like attorney trust account funds — needed to be placed in demand accounts? The answer would have to be "yes" if IOLTA is deemed a taking. Such a novel claim would turn taking's jurisprudence on its head.

The ability to earn interest on what, for all practical purposes amounted to a demand account, commenced only in June of 1972, when the Consumers Savings Bank of Worcester, Massachusetts, offered the first savings accounts that permitted a "Negotiable Order of Withdrawal" (NOW accounts).²¹ However, it was not until December 31, 1980, that NOW accounts became available nationwide,²² thereby permitting the Florida IOLTA program to begin. Lawyers could convert their interest-free trust accounts into interest-paying NOW accounts. The economic benefits gained were reallocated from financial institutions to the public. From the client's perspective, nothing changed.

²⁰(...continued)

(1947), the court held that § 11(b) required financial institutions to stop paying interest on pre-1933 demand deposits, even where the interest was being paid pursuant to an express contract between the bank and the depositor.

²¹D. Crane & M. Riley, *NOW Accounts: Strategies for Financial Institutions* 3 (1980).

²²The Consumer Checking Account Equity Act of 1980, Title III of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 303, 94 Stat. 146 (1980), codified at 12 U.S.C. § 1832(a) (1994).

NOW accounts are not available to all depositors. Instead, NOW accounts must consist "solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit," or of funds belonging to public entities.²³ NOW accounts furnish the only basis for interest-paying checking accounts. Restrictions on NOW account usage, however, bar all profit-making clients, other than sole proprietors, from utilizing them. The IOLTA administering agency, because it is a qualified charitable organization, is able to receive the income from the NOW account.²⁴

Prior to IOLTA, most client funds were deposited in aggregated, interest-free checking (demand) accounts.²⁵ The use of demand accounts was necessary so that the attorney could return the client's money immediately upon request. Rule 1.15, *Model Rules of Professional Conduct* (ABA 1983). Moreover, because the attorney cannot personally benefit from any earnings generated by the trust account, even to the extent of using the earnings to offset bank service charges,²⁶ only banks benefited from the funds placed in an

²³12 U.S.C. § 1832(a) (1994).

²⁴Middlebrooks, *The Interest on Trust Accounts Program, Mechanics of Its Operation*, 56 Fla. B.J. 115 (1982).

²⁵Generally, a lawyer was under no obligation to place client funds in an interest-bearing account. ABA *Annotated Model Rules of Professional Conduct* 236 (3d ed. 1996).

²⁶ABA Comm. on Ethics & Professional Responsibility, Informal Op. 545 (1962); ABA Comm. on (continued...)

attorney's trust account. Thus, if there is merit to Respondents' argument, it must also follow that the previous combination of attorney and banking restrictions worked a similar taking, although in favor of banks rather than the provision of legal aid to the poor.

In short, history shows that banking barriers, coupled with attorney trust account mandates, prevented funds placed in attorney trust accounts from being made productive for the client. Now, with many of the banking barriers removed, the transaction costs incurred by attorneys and financial institutions still form a very real barrier to making nominal or short term deposits productive for the client. The unique character of the IOLTA program rests in part on its ability to overcome both barriers. The economic barrier is overcome only because the aggregation of funds can produce income net of expenses which non-aggregated funds are unable to generate. Additionally, by providing that income produced by a NOW account belongs to a non-profit charitable corporation or a public entity, the banking barrier is overcome. It is accurate to say that without IOLTA there would be no net income in the first place.

²⁶(...continued)

Ethics & Professional Responsibility, Informal Op. 991 (1967). Some attorneys reaped a benefit from their client's funds by way of reduced cost banking services, lower cost loans, and other free or reduced cost services. The ethical propriety of that practice is doubtful, see Opinion 88-20, Committee on Professional Status of the Bar Association of Nassau County, N.Y., ABA/BNA *Lawyers' Manual on Professional Conduct* §901:6262 (4/20/88), but has never been directly addressed by an ABA or state-level ethics opinion.

It is not enough for IOLTA opponents to say that earnings follow principal. One must also look to all the limitations that accompany a claim to such earnings. The distinction between net and gross income is one such limitation. Were an attorney trust account actually a trust arrangement, nobody would suggest that the beneficiary would be entitled to the income without the trustee first deducting the cost of producing that income.²⁷ Likewise, the restrictions on who can use a NOW account constitute another limitation. Because of the costs involved, as well as the restrictions imposed by banking laws and rules of professional conduct, the claim of the owner of a nominal or short term deposit to the interest earned by that deposit does not qualify as property under the *Roth* constitutional definition. Certainly, there are no "rules or mutually explicit understandings"²⁸ that the client will receive the interest. The time-honored practice has been directly to the contrary.

Thus, the combination of the type of the funds typically placed in attorneys' trust accounts (see the discussion of typical deposits, *supra*, beginning at p. 6), the restrictions placed on attorneys' handling of those funds, the evolution of banking law, and the economic realities of nominal or short term deposits, all preclude the conclusion that a client has a legitimate claim of entitlement to interest generated only because of the IOLTA program.

²⁷3 A. Scott, *The Law of Trusts* §§ 242, 244 (4th ed 1988 & Supp. 1996).

²⁸*Board of Regents, supra*, 408 U.S. at 577; *Perry v. Sindermann*, 408 U.S. 593, 601 (1972).

D. Absence of a Taking

Having found a property interest, despite the lack of Texas law establishing any entitlement in the circumstances herein presented, the Fifth Circuit overlooked the multifactor balancing test of *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978), which examines taking claims by looking to the character of the governmental action and the economic impact of that action on the claimant, and particularly, the extent to which the action has interfered with distinct investment-backed expectations. Yet, *Penn Central* leads to the inevitable conclusion that IOLTA programs do not take the client's property. Or as Justice Peckham put it nearly a century ago, if a claimant is "not injured to the extent of a penny ... his abstract rights are unimportant." *Hooker v. Burr*, 194 U.S. 415, 419 (1904).

Because established takings doctrine requires at least some loss, and because Respondents admit that they suffered no loss due to the operation of the Texas IOLTA program, their Fifth Amendment claim is not well-founded.²⁹ *Webb's Fabulous Pharmacies, Inc. v. Beckwith, supra*, 449 U.S. 155 is not to the contrary. The fund at issue in *Webb's*, more than \$1.8 million, clearly could, and did, produce income net of expenses. *Webb's* certainly does not preclude the IOLTA

²⁹If IOLTA is deemed a taking, those clients who object to having their funds deposited in an IOLTA account would be entitled to "just compensation." As Judge Benavides said in dissenting from the Fifth Circuit's failure to grant rehearing en banc, "[b]ecause the fair market value of the earnings of IOLTA-eligible funds is \$0, the client would be entitled to nothing." *Washington Legal Foundation v. Texas Equal Access*, 94 F.3d 996 (5th Cir. 1996), *reh. and reh. en banc denied*, 106 F.3d 640, 644 (5th Cir. 1997)(Benavides, J., dissenting).

proponent's calculus that recognizes the real cost of producing that net income.

The Eleventh Circuit fully understood the absence of net income-producing ability on the part of a nominal or short term deposit when it rejected a taking claim, premised on the rule of *Himely v. Rose*, 9 U.S. (5 Cranch) 313, 319 (1809), that "interest goes with the principle, as the fruit with the tree," by noting that the "illustration necessarily assumed the existence of a fruit-bearing tree." *Cone, supra*, 819 F.2d at 1004. Absent at least some real loss, no caselaw from this or any other court, with the exception of the Fifth Circuit, turns regulation into a taking.

CONCLUSION

Respondent Mazzone admits that the client funds he places in his IOLTA account "cannot practicably be placed into separate interest-bearing accounts, because the additional costs of establishing and maintaining such accounts usually would exceed any interest I could earn for my clients."³⁰ Likewise, Respondent Summers admits that his funds were placed in an IOLTA account because his attorney told him that "the cost of establishing and administering a separate account ... most likely would exceed any interest that could be earned on those funds."³¹

This lack of income-producing ability is the core concept supporting IOLTA. No client has a property interest in the interest income generated only because of IOLTA.

³⁰Affidavit of Michael J. Mazzone in Support of Respondents' Motion for Summary Judgment, at ¶ 4.

³¹Affidavit of William R. Summers in Support of Respondents' Motion for Summary Judgment, at ¶ 6.

Because no client is injured, even to the extent of a penny, *amici curiae* urge that the Fifth Circuit be reversed.

If IOLTA is abolished, financial institutions will receive a windfall by again benefiting from the use of interest-free money, programs to improve the administration of justice and the delivery of pro bono services will go unfunded, and a large percentage of the poor currently served by legal aid programs will again be denied access to the justice system. Yet clients with nominal or short-term deposits will find their position totally unchanged.

Respectfully submitted,

* Peter M. Siegel, Esq.
Randall C. Berg, Jr., Esq.
JoNel Newman, Esq.
Florida Justice Institute, Inc.
Suite 2870
200 South Biscayne Blvd.
Miami, Florida 33131-2310
305-358-2081

Arthur J. England, Jr., Esq.
Greenberg, Traurig, Hoffman,
Lipoff, Rosen & Quentel, P.A.
1221 Brickell Avenue
Miami, Florida 33131
305-579-0605

Attorneys for *Amici Curiae*

* Counsel to be served,
Member of the Bar of the Court

ADDENDUM

THE *AMICI CURIAE*

Alabama Law Foundation, Inc.
Alabama State Bar
Arizona Bar Foundation
State Bar of Arizona
Arkansas Bar Association
Arkansas IOLTA Foundation, Inc.
The Legal Services Trust Fund Commission of the
State Bar of California
The State Bar of California
Colorado Bar Association
Colorado Lawyers Trust Account Foundation
Connecticut Bar Association
The Connecticut Bar Foundation
The Florida Bar
The Florida Bar Foundation
Georgia Bar Foundation
Hawaii Justice Foundation
Hawaii State Bar Association
Idaho Law Foundation, Inc.
Idaho State Bar
Lawyers Trust Fund of Illinois
Illinois State Bar Association
Indiana State Bar Association
Lawyer Trust Account Commission of the Supreme
Court of Iowa
The Iowa State Bar Association
Kansas Bar Foundation
Kentucky IOLTA Fund
Louisiana Bar Foundation
Louisiana State Bar Association
Maine Bar Foundation
Maine State Bar Association
Maryland Legal Services Corporation

Maryland State Bar Association
 State Bar of Michigan
 Michigan State Bar Foundation
 Minnesota State Bar Association
 The Mississippi Bar Foundation
 The Missouri Bar
 Missouri Lawyer Trust Account Foundation
 Montana Law Foundation
 State Bar of Montana
 National Association of IOLTA Programs, Inc.
 National Legal Aid and Defender Association
 Nebraska Lawyers Trust Account Foundation
 Nebraska State Bar Association
 Nevada Law Foundation
 State Bar of Nevada
 New Hampshire Bar Association
 New Hampshire Bar Foundation
 The IOLTA Fund of the Bar of New Jersey
 New Jersey State Bar Association
 New Jersey State Bar Foundation
 State Bar of New Mexico
 New Mexico Bar Foundation
 IOLTA Fund of the State of New York
 New York State Bar Association
 North Carolina Bar Association
 North Carolina Association of Black Lawyers
 North Carolina State Bar Plan for IOLTA
 Ohio Legal Assistance Foundation
 Ohio State Bar Association
 Oklahoma Bar Association
 Oklahoma Bar Foundation, Inc.
 Oregon Law Foundation
 Oregon State Bar
 Pennsylvania Bar Association
 Lawyer Trust Account Board (Pennsylvania)
 Philadelphia Bar Association
 Rhode Island Bar Association

Rhode Island Bar Foundation
 South Carolina Bar
 South Carolina Bar Foundation
 State Bar of South Dakota
 Tennessee Bar Foundation
 Tennessee Bar Association
 Vermont Bar Association
 Vermont Bar Foundation
 The Virginia Bar Association
 Legal Services Corporation of Virginia
 Legal Foundation of Washington
 Washington State Bar Association
 King County Bar Association (Washington)
 West Virginia Bar Foundation
 West Virginia State Bar
 Wisconsin Trust Account Foundation, Inc.

(11)

Supreme Court, U. S.

F I L E D

AUG 25 1997

No. 96-1578

CLERK

In The
Supreme Court of the United States
October Term, 1996

HON. THOMAS R. PHILLIPS, et al.,
Petitioners,
vs.

WASHINGTON LEGAL FOUNDATION, et al.,
Respondents.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

**BRIEF OF AMICUS CURIAE CONFERENCE OF CHIEF
JUSTICES IN SUPPORT OF THE PETITIONERS**

CHARLES ALAN WRIGHT
727 East Dean Keeton St.
Austin, Texas 78705
(512) 471-7188

*BRIAN J. SERR
1400 South 5th St.
P.O. Box 97288
Waco, Texas 76798-7288
(254) 710-3611

Attorneys for Amicus Curiae

**Counsel of Record,
Member of the Bar
of this Court*

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INTEREST OF AMICUS CURIAE¹

The Conference of Chief Justices consists of the highest justice or judge in each of the fifty states, the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, Guam, and the Northern Mariana Islands. The purpose of the Conference of Chief Justices is to provide an opportunity for consultation among the highest judicial officers of the several states, commonwealths, and territories, concerning matters of importance in the operation of state courts and judicial systems. In large part, the ultimate goal of the Conference is to improve the administration of justice.

The case of *Phillips v. Washington Legal Foundation* involves a direct attack on state-based efforts to improve the quality and equality of justice in state courts. All fifty states and the District of Columbia have adopted an IOLTA program, the ultimate purpose of which is to exploit an unused economic resource in order to generate funding for improved delivery of legal services to the poor. While there are minor variations in IOLTA programs from state to state, the essential premise is the same – nominal or short-term client deposits in lawyer trust accounts, which by themselves are incapable of generating interest in excess of the banking costs of account management, can be pooled into fewer accounts

¹ Statement required by Supreme Court Rule 37.6 – This brief has been exclusively authored by the Attorneys for *Amicus Curiae* indicated on the cover of this brief, neither of whom is an attorney for any of the parties to this litigation; and there was no monetary contribution to the preparation or submission of this brief made by any person or entity other than the *amicus curiae*.

thereby reducing banking costs and earning interest in excess of costs. In short, IOLTA programs produce interest earmarked for the nonprofit IOLTA foundations, interest which could not otherwise have been earned by those client deposits eligible for IOLTA pooling. The interest generated by the states' IOLTA programs is vital to the states' pursuit of equal justice under the law.

IOLTA programs not only make a vital contribution to state judicial interests, these programs for the most part are a creature of state judicial invention. Although five states established their IOLTA programs through legislation, the programs in every other state have been adopted by the various state supreme courts. And, of course, because of the contributions made to the administration of justice even in those few states where IOLTA was a product of legislative rather than judicial creativity, the Conference of Chief Justices' interest in this case is apparent. Indeed, the Conference voted unanimously to authorize the filing of this *amicus curiae* brief at its Annual Business Meeting on July 31, 1997. This *amicus curiae* brief is being filed with the written consent of all parties.

SUMMARY OF ARGUMENT

Clients with lawyer trust accounts eligible for IOLTA pooling have no constitutionally protected property interest in receiving any portion of the interest generated by the pooled account. This Court has established that the hallmark of "property" cognizable under the Fifth and

Fourteenth Amendments is a "legitimate claim of entitlement." *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972). Whether a litigant possesses such a claim is assessed in light of "existing rules and understandings" that stem not from the Constitution itself but from an independent source such as state law. *Id.* The existing rules and understandings that determine legitimate claims of entitlement to IOLTA interest absolutely preclude clients whose lawyer trust account deposits are eligible for aggregation in an IOLTA account from establishing any legitimate claim of entitlement to the interest generated by the pooled account.

The only trust account deposits that are eligible for pooling in an IOLTA account are those which are too nominal or too temporary to have any reasonable expectation of earning interest for the client. TEXAS RULES OF COURT - STATE, *Rules Governing the Operation of the Texas Equal Access to Justice Foundation*, Rule 6 (West 1997) (hereinafter "IOLTA Rules"). The IOLTA rules, which have the force of state law, as well as the terms of the IOLTA deposit contracts between lawyers and banking institutions, clearly establish that the interest belongs to the nonprofit IOLTA foundation. IOLTA Rule 4. These rules and contracts are the "existing rules and understandings" that establish those "legitimate claims of entitlement" essential to constitutionally protected "property" interests; and they could not be clearer. A client, at most, possesses an "abstract desire" to enjoy the interest, which is precisely how this Court describes a constitutionally insufficient interest in property. *Roth*, 408 U.S. at 577. Even prior to the advent of IOLTA programs, the trust account deposits which today are eligible for

IOLTA pooling had no chance of generating interest for the client's enjoyment, at first because a combination of ethical considerations and banking laws effectively prohibited it, and later due to the simple economic reality that banking costs in establishing and administering such nominal or short term accounts would always exceed the accounts' capacity to generate interest. In sum, IOLTA programs have changed nothing about the expectations of those clients whose trust account deposits are today eligible for IOLTA pooling – they had no reasonable expectations of enjoying interest earned on their accounts pre-IOLTA; and they have none post-IOLTA. The “existing rules and understandings” – ethical rules, banking laws, economic reality, IOLTA rules, deposit contracts – have *always* foreclosed reasonable expectations that clients will enjoy interest earned by the nominal or short-term accounts that are now eligible for deposit into a pooled IOLTA account.

The Fifth Circuit's ruling that clients enjoy a “property” right to IOLTA interest was based on a misconstruction of this Court's opinion in *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980), and a gross misreading of state law. Unlike the present case, the year-long \$1.8 million interpleader deposit in *Webb's* was independently capable of generating interest in excess of account management costs; and the interpleader fund in *Webb's* was established *only* for the benefit of *Webb's* creditors, while the pooled IOLTA accounts are established not simply for the safekeeping of a client's principal, but to create interest earmarked for the nonprofit IOLTA foundation. Additionally, the Fifth Circuit carelessly relied on a highly general rule of state law – “interest follows principal” –

without seriously considering far more specific rules having the force of state law (the Texas Supreme Court's IOLTA Rules) that far more likely constitute those “existing rules” on which *Roth's* “legitimate claims of entitlement” are based, and which expressly vest those claims of entitlement in the nonprofit IOLTA foundation.

Unable to establish a property right to IOLTA interest, respondents alternatively claim a property right to deny others the benefits of their deposited *principal*. Although clients certainly have a constitutionally protected “property” interest in the principal, that no more includes the right to deny others the benefits of the IOLTA interest than it includes the right to enjoy the interest themselves. Because this Court identifies the whole range of constitutionally protected property interests by reference to *Roth's* “existing rules and understandings that stem from an independent source such as state law,” it is apparent that the IOLTA rules and the IOLTA deposit contracts between lawyer and bank foreclose any reasonable client expectation of a right to deny others the IOLTA interest, just as they foreclose any reasonable client expectation to enjoy the benefits of IOLTA interest personally. Therefore, a client's “right” to deny others the benefits of his principal, like his “right” to enjoy the interest, is more “abstract desire” than “legitimate claim of entitlement.”

Even though a “right to exclude” is sometimes within the range of protectable interests in property, such a right normally presupposes an interference with property of the type associated with a traditional trespass, a degree of interference simply absent from the present case. This Court has ruled, for example, that a landowner's right to exclude military flights from the airspace above his land

depends on his ability to establish a substantial interference with his use and enjoyment of the property. *United States v. Causby*, 328 U.S. 256, 266 (1946). Moreover, even if a client has a "right to deny" others the benefits of the few dollars and cents of interest attributable to his portion of the pooled IOLTA account, there is no state coercion that denies him the exercise of that "right." In many cases, if not most of them, the creation of a lawyer trust account is a voluntary decision made mutually by lawyer and client in order to facilitate the efficient delivery of legal services to the client. The state has neither coerced clients into depositing funds into such an account nor mandated that they set up an account so nominal in amount or so short-term that it cannot generate interest on its own. Finally, even if a client could establish a "right to deny" which has somehow been "taken" from him, that does not make it a compensable taking. The law is replete with examples of much more substantial restrictions on an owner's right to deny others uses of his property than are implicated by IOLTA programs – e.g., prohibitions on any denial of uses of commercial property based on race, religion, ethnicity, gender, etc. This Court long ago said: "Government could hardly go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922). In sum, respondents "right to deny" argument establishes, at most, a government-authorized "use" of their principal, but it is a "use" that hardly constitutes a compensable taking.

This case is ultimately about whether the Takings Clause can be distorted to authorize substantial intrusions into areas that fundamentally are matters of state concern. There are few arenas in which the states have stronger interests than in the administration of their own judicial systems. Moreover, in many cases, the states have a constitutional obligation to provide the poor equal access to the state judicial system – an obligation which states are pursuing in part through IOLTA programs. In light of such significant state interests and obligations, this Court should require a much stronger demonstration of a taking of "property" than can be shown in this case before reading the Takings Clause to wreak havoc with all fifty states' creative efforts to improve the administration of justice in state courts.

ARGUMENT

I. A Client with Lawyer Trust Account Deposits Eligible for Pooling in an IOLTA Account has No "Property" Right, Under the Fifth and Fourteenth Amendments, to the Interest Generated by the Pooled Account.

This Court's seminal description of constitutionally protected "property" interests is contained in *Board of Regents of State Colleges v. Roth*, 408 U.S. 564 (1972). According to *Roth*, "property interests are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law – rules or understandings that secure certain benefits and that support claims of entitlement to those

benefits." *Id.* at 577. This Court further described "legitimate claims of entitlement" as "those claims upon which people rely in their daily lives." *Id.* Just as importantly, the Court provided a curt description of when litigants' claims of beneficial property interests do *not* constitute legitimate claims of entitlement: "[A] person clearly must have more than an abstract need or desire for [the claimed benefit]. He must have more than a unilateral expectation of it." *Id.* With these descriptions and limitations, the Court sought to set boundaries on "property," not only to give the constitutional term "some meaning," *id.* at 572, but to avoid trivializing what the Court expressly described as a "majestic" term and a "great constitutional concept." *Id.* at 571. Indeed, it is difficult to conceive of a less majestic notion of "property" than respondent's fantasy that he owns that which his paltry or short-term "investment" could not independently earn and which could not be earned in the absence of IOLTA's creative pooling of otherwise nonproductive lawyer trust accounts.

Although *Roth* is a procedural due process case, its concept of "property" also controls Takings Clause cases. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1030 (1992). The *Lucas* opinion emphasized that the Court traditionally resorts to "existing rules or understandings that stem from an independent source such as state law" in identifying and defining the range of interests that qualify for protection as "property" under the Fifth or Fourteenth Amendments. *Id.*, citing *Roth*, 408 U.S. at 577. Justice Kennedy's concurring opinion in *Lucas* further explained that property interests in the Takings Clause

arena must be assessed in light of "reasonable investment-backed expectations." 505 U.S. at 1034 (Kennedy, J., concurring), citing *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979); *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978). According to Justice Kennedy, "[t]he expectations protected by the Constitution are based on objective rules and customs that can be understood as reasonable by all parties involved." 505 U.S. at 1035 (Kennedy, J., concurring). Such mutually understood expectations based on objective rules and customs are in direct contrast to the mere "unilateral expectation" or "abstract desire" held up in *Roth* as woefully insufficient to generate a legitimate claim of entitlement. Thus, both the majority and concurring opinions in *Lucas* conceive of "property" in a manner completely consistent with *Roth*.

Viewed in light of *Roth* and *Lucas*, it is apparent that a client's claim in whatever amount to interest earned by a pooled IOLTA account is more illusory than real, more "abstract desire" than "legitimate claim of entitlement." Indeed, respondents cannot in good conscience claim that clients whose deposits are independently incapable of earning interest (and therefore eligible for IOLTA pooling) have ever harbored *even a unilateral expectation* of enjoying the interest earned by a pooled IOLTA account. Of course a mere "unilateral expectation" of receiving some benefit is the epitome of *nonproperty* under *Roth*. That clients similarly situated to respondent Summers have never enjoyed even a constitutionally *insufficient* "unilateral expectation" of receiving interest from lawyer trust accounts, in either the pre-IOLTA or post-IOLTA

world, shows just how far short of the requisite "legitimate claim of entitlement" respondent's claim falls. Pre-IOLTA, there was absolutely no hope for the client to earn interest on client funds held by the lawyer in trust, regardless of the size of the principal, at least until 1980 changes in banking law.² Even after the 1980 changes in banking law permitted interest-bearing demand accounts (NOW accounts), such accounts offered no hope of benefits for those clients, such as respondent Summers, whose deposits were nominal or short-term in nature.³ The post-IOLTA world is no friendlier to client expectations of

² Ethical rules require lawyer trust account monies to be available on a client's demand and, before 1980, banking laws did not permit interest-bearing demand accounts. Therefore, prior to 1980, the only banking option available to attorneys for holding a client's funds in trust was a non-interest-bearing demand deposit account.

³ The bank's service charges would exceed the interest earned in a separate account, and a lawyer's administrative and accounting expenses in managing a pooled account would exceed any interest generated by such an account. Moreover, what lawyer would offer such services to legal clients? Ethical rules prohibit a lawyer's profiting from the client's trust funds, and lawyers presumably prefer to be lawyers rather than bankers/accountants. Indeed, the efforts needed to manage such an account would quite clearly defeat the convenience of having lawyer trust accounts in the first place. Just as importantly, banking regulations permit NOW accounts only if the entire beneficial interest in the funds deposited are held by one or more individuals or by a nonprofit organization. 12 U.S.C. § 1832(a)(2). Thus, if even one of the lawyer's clients is a for profit partnership or corporation, interest could not be earned on a pooled account absent IOLTA's nonprofit umbrella, even if the lawyer wanted to spend valuable time managing such an account in an effort to generate insignificant amounts of interest for clients.

receiving interest on lawyer trust account deposits that are either too nominal or too temporary to generate any financial benefit for the client. Although IOLTA programs permit (and in some states, like Texas, require) lawyers to pool such accounts in order to create a single account with interest-bearing capability, the terms of the lawyer's deposit contract with the bank clearly establish that the interest generated will belong to the nonprofit IOLTA foundation. *See, e.g., TEXAS RULES OF COURT – STATE, Rules Governing the Operation of the Texas Equal Access to Justice Foundation, Rule 4* (West 1997) (hereinafter "IOLTA Rules"). Thus, in regard to clients' expectations of earning interest on deposits of nominal or short-term funds in a lawyer trust account, IOLTA has changed nothing. Clients had no expectation of enjoying interest before IOLTA and no expectation after. In sum, no client (and certainly no lawyer) has ever had any legitimate expectation of receiving interest from the types of lawyer trust account deposits that are subject to IOLTA pooling. Therefore, any "expectation" claimed by respondents in the present case is surely the "unilateral expectation" that this Court in *Roth* found to exemplify *nonproperty*, rather than the "legitimate claim of entitlement" that constitutes a protected property interest.

In light of the types of client deposits eligible for IOLTA pooling, and the customary pre-IOLTA treatment of such deposits in accordance with both banking laws and a lawyer's ethical obligations, it is evident that a client's claim to the interest generated by a pooled IOLTA account fits none of the various descriptions of "property" propounded in *Lucas* and *Roth*. As already argued,

such a claim is much more akin to an unprotected "unilateral expectation" (if even that) than a "legitimate claim of entitlement" characteristic of protected property. Neither is respondent's claim to IOLTA interest one of those "claims upon which people rely in their daily lives," *Roth* at 577, nor a "reasonable investment-based expectation," *Lucas* at 1034 (Kennedy, J., concurring), nor consistent with "existing rules or understandings," *Roth* at 577, *Lucas* at 1030, nor "based on objective rules and customs that can be understood as reasonable by all parties involved." *Lucas* at 1035 (Kennedy, J., concurring). Indeed, due to banking laws, economic realities, a lawyer's ethical obligations, state law IOLTA rules, and IOLTA account deposit contracts, it is silly even to think of the nominal or short-term client deposits subject to IOLTA pooling as "investments." (One might as well "invest" by putting money in a shoe box under the bed.) Consequently, it is compounded silliness to urge that clients have a "reasonable investment-based expectation" of receiving the portion of IOLTA interest attributable to their deposit when their deposit is incapable of earning them interest on its own, and when the cost of attribution would quite clearly defeat the purpose of pooling in the first place. Moreover, in the present case, the "existing rules or understandings" and "the objective rules and customs" that influence expectations and determine whether such expectations are merely unilateral or instead are mutually understood by all parties involved so as to create a legitimate claim of entitlement can only be the aforementioned banking laws, economic realities, ethical obligations, state law IOLTA rules, and IOLTA deposit contracts. These customs/rules/understandings

literally shout to both lawyer and client: "There is no hope of earning interest for the client on the nominal or short-term deposits eligible for IOLTA pooling." Therefore, this case surely poses a claim to property that is no more than the "abstract desire" that exemplifies *non-property* under this Court's Fifth and Fourteenth Amendment precedent.

The respondents' claim of client entitlement to IOLTA interest is analogous to the untenured university professor's claim on future employment in *Roth*, a claim which this Court refused to recognize as "property." 408 U.S. at 578. Under Wisconsin law, an untenured university professor enjoyed only year-to-year employment. *Id.* at 566. This Court ruled that any "property" interest enjoyed by the professor was created and defined by the terms of his appointment. *Id.* at 578. Because those terms covered his interest in employment for just one year, "[t]hey supported absolutely no possible claim of entitlement to re-employment." *Id.* Consequently, although the professor may have had an abstract concern in being rehired, he did not have a "property" interest. *Id.* Similarly, in this case, the controlling terms of the client's deposit of lawyer trust fund monies – the IOLTA rules and the deposit contract – constituted no promise that the client would receive a portion of IOLTA interest proportional to his principal. Instead, the controlling terms – *i.e.*, those existing rules and understandings that distinguish unilateral expectations from legitimate claims of entitlement – clearly spelled out that the interest from the pooled account would accrue only to the benefit of the IOLTA foundation. Although the client's expectation to benefit from his *principal* in some way was a legitimate

claim of entitlement (like Professor Roth's expectation of employment for one year), any expectation to benefit from the *interest* (like Professor Roth's expectation of future employment) was merely "unilateral." Indeed, Professor Roth had a much stronger expectation than the client here. At least the applicable rules in *Roth* created a *possibility* that the University, in its discretion, would extend the professor's employment. But a client whose lawyer trust account deposit is too meager or too transient to earn interest on its own does not have even the *potential* of enjoying IOLTA interest under existing rules and understandings; nor have such deposits ever harbored such a potential under the rules or understandings of any era.

A quick examination of the types of interests which this Court has recognized as constitutionally protected "property" sheds further light on respondents' position. Indeed, the client's asserted "property" right to enjoy the benefits of IOLTA interest pales in comparison to the following well-recognized property interests:

- land (*Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992));
- leaseholds (*Almota Farmers Elevator and Warehouse Co. v. United States*, 409 U.S. 470 (1973));
- easements (*United States v. Virginia Electric and Power Co.*, 365 U.S. 624 (1961));
- mineral rights (*Texaco, Inc. v. Short*, 454 U.S. 516 (1982) (holding, however, that such mineral rights lapsed under state law due to 20 consecutive years of nonuse));
- airspace (*United States v. Causby*, 328 U.S. 256, 264 (1946) (finding property interest in

"at least as much of the space above the ground as he can occupy or use in connection with the land"));

- water rights (*International Paper Co. v. United States*, 282 U.S. 399 (1931));
- franchises (*Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909));
- security interests (*Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935));
- materialmen's liens (*Armstrong v. United States*, 364 U.S. 40 (1960));
- trade secrets (*Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984));
- patent rights (*Hollister v. Benedict and Burnham Manufacturing Co.*, 113 U.S. 59 (1885));
- tenured employment (*Board of Regents of State Colleges v. Roth*, 408 U.S. 564 (1972));
- valid contracts (*Lynch v. United States*, 292 U.S. 571 (1934));
- a driver's license (*Bell v. Burson*, 402 U.S. 535 (1971));
- an occupational license (*In re Ruffalo*, 390 U.S. 544 (1968)).

What each of these "property" rights has in common is an assurance, based on existing rules and understandings, that the "thing" at least bears the potential of being exploited in some way to the holder's advantage. The IOLTA interest in this case, at least in regard to any client expectation of enjoyment, stands in sharp contrast. Existing rules having the force of state law expressly foreclose

even the possibility that a client might enjoy the IOLTA interest; and even absent IOLTA's creative pooling mechanism there would be no potential for the enjoyment of interest from such a nominal or short-term account due to economic reality. In terms of "reasonable investment-backed expectations," client has *nothing*; the IOLTA program has, consequently, taken *nothing*. Therefore, a client's claim to IOLTA interest simply does not belong in the pantheon of this Court's heretofore recognized constitutional interests in property.

The Fifth Circuit mistakenly relied on this Court's decision in *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980), in identifying a client's property right to the interest generated by a pooled IOLTA account. In that case Eckerd's agreed to purchase Webb's Fabulous Pharmacies for \$1.8 million but, at closing, Webb's debts appeared to be greater than the purchase price. In order to protect itself, Eckerd's filed a complaint of interpleader and tendered the purchase price to the court. Almost a year later, the court appointed a receiver for Webb's and a dispute arose when the clerk refused to turn over the interest that was earned on the interpleaded fund while it was held by the clerk, interest which eventually amounted to over \$100,000. This Court held that the county's refusal to turn over the interest on the interpleaded fund was an unconstitutional taking. *Id.* at 164-165. Although the interest followed the interpleaded principal in *Webb's*, giving the receiver a "property" interest in both principal and interest, the *Webb's* case is distinguishable from the present dispute over ownership of IOLTA interest in several fundamental ways.

First and foremost, unlike the deposits subject to IOLTA pooling, the year-long \$1.8 million deposit in *Webb's* was independently capable of generating interest for the benefit of the principal's owner. The *Webb's* deposit was neither nominal nor short-term. Additionally, because the clerk in *Webb's* had already deducted an administrative fee, it was plainly apparent that the year-long \$1.8 million deposit was independently capable of earning interest in excess of administrative costs. 449 U.S. at 162. In other words, the deposit in *Webb's* was quite capable of generating interest income without a creative IOLTA-style pooling of multiple deposits. Therefore, unlike the IOLTA interest, the interest in *Webb's* could have been earned separate and apart from the interpleader fund. Consequently, also unlike the present case, there was no possible way that the clerk in *Webb's* could take credit for creating the opportunity for generating interest. In short, the state in *Webb's* caused an obvious economic injury to the owner of the interpleader fund's principal, while the states' IOLTA programs create an economic opportunity where none had theretofore existed. Indeed, this Court explained in *Webb's* that the clerk's retention of the interest placed an economic burden on interpleaders with no offered police power justification, *id.* at 163, and emphasized that the Takings Clause stands as a shield against such arbitrary uses of governmental power. *Id.* at 164. The present case stands in sharp contrast – the IOLTA programs are operated so as to place no economic burden on trust account depositors, and the justice afforded by IOLTA programs to those who could not otherwise afford it surely undercuts any charges of governmental arbitrariness.

A second fundamental distinction between *Webb's* and the present case is that the interpleader fund in *Webb's* was specifically held only for the ultimate benefit of *Webb's* creditors. *Id.* at 161. Indeed, that was the whole point of filing the interpleader action and depositing the purchase price for *Webb's* assets into the fund. Therefore, according to the Court, *Webb's* creditors had more than just a unilateral expectation. *Id.* In marked contrast, the monies deposited into pooled IOLTA accounts in accordance with a state's IOLTA rules are pooled for one reason only – to generate interest for the IOLTA foundation and its public interest programs. IOLTA pooling expressly is *not* done to create some *de minimis* pro rata benefit for the various owners of the principal.

The Fifth Circuit's misapplication of *Webb's* is far from the only flaw in its opinion. The characterization of IOLTA programs as a "modern-day attempt at alchemy," 94 F.3d at 1000, reveals the depth of its misunderstanding of how IOLTA produces interest. IOLTA programs certainly do not create something out of nothing. Rather, IOLTA's pooling of small or short-term accounts into a larger, more stable single account increases the efficiency by which banks can manage deposited funds. This increased efficiency reduces the costs of banking, correspondingly reducing banks' need to offset costs against interest earned, thereby creating a profit that would not otherwise exist. There is nothing "magic" about IOLTA – it is good old-fashioned efficiency. Perhaps governmental programs that increase efficiency are so rare that the Fifth Circuit could not believe its eyes. Nevertheless, however rare, when government does come up with creative ways both to increase efficiency and to benefit the public, such

efforts are worthy of more than the skepticism shown by the Fifth Circuit. In any event, what IOLTA pooling ultimately accomplished was to transfer the expected enjoyment of the interest generated by lawyer trust accounts from banks to the IOLTA foundation, at no harm to banks due to their reduced costs of administration.

If there has been any alchemy attempted in this case it was surely practiced by the Fifth Circuit when it found that clients have a protectable property interest despite the complete absence of any reasonable expectation – based on rules, customs, or mutually held understandings – of enjoying IOLTA interest. According to the Fifth Circuit, a property right to IOLTA interest attaches the moment the interest accrues, before banks deduct charges. 94 F.3d at 1003. That observation begs the question; the issue is not *whether* the interest is property but, rather, *who* has a legitimate claim of entitlement thereto. Of course, the deposit contracts and the state IOLTA rules declare that the interest is accruing for the benefit of the IOLTA program, therefore rendering any client expectation regarding enjoyment of the interest unreasonable and merely "unilateral." See IOLTA Rule 4. But even if the Fifth Circuit's point is that interest would accrue on a nominal or short-term account even without IOLTA pooling, thereby giving the client some temporary property (albeit property that the bank will retain to offset its costs and never distribute to the client), the point still misses the mark. Such an expansive view of constitutionally protected property not only trivializes the Fifth Amendment in direct contravention of *Roth's* characterization of "property" as a "majestic" term, but causes a fundamental constitutional issue to turn on something as mundane

and varied as a given bank's internal accounting practices. Surely, the "legitimate claim of entitlement" that constitutes property means something more than an expectation that a bank clerk might make an entry on some ledger.

Perhaps the most disturbing aspect of the Fifth Circuit opinion, at least from a states' rights standpoint, is its cavalier reliance on a general rule of state law – interest follows principal – without even bothering to consider whether the state may have carved out a specific exception. See 94 F.3d at 1000. Such a superficial approach to interpreting state law permits federal courts to manipulate highly generalized legal principles into absolute rules from which the states have no effective power to carve out specific exceptions. Had the Fifth Circuit taken a closer look at Texas state law in this case, it surely would have recognized specific rules and understandings having the force of state law – the Texas Supreme Court's IOLTA Rules and the IOLTA deposit contracts – that clearly control the question of who is entitled to the IOLTA interest. Such situation-specific rules and mutual agreements clearly trump the overly general "interest follows principal" approach in determining who has a legitimate claim of entitlement to the IOLTA interest based upon *Roth's* "existing rules or understandings."

II. A Client Whose Lawyer Trust Account Deposits are Eligible for IOLTA Pooling Suffers No Taking of any Cognizable Property Right to Deny Others a Beneficial Use of Client Property.

To the extent respondents' "right to exclude" argument rests on an underlying assumption that the IOLTA interest is the property of the depositor/client, that assumption has already been shown to fall far short of a "legitimate claim of entitlement." On the other hand, even if the argument is premised upon an asserted right to exclude others from the benefits of a client's deposited principal, respondents' fanciful proposition is meritless for several reasons. First, any such "right", like any other asserted property right, qualifies for protection only by reference to *Roth's* "existing rules or understandings." *Lucas*, 505 U.S. at 1030 (the *Roth* characterization is used "to define the range of interests that qualify for protection as 'property' under the Fifth and Fourteenth Amendments"). In *Lucas*, the majority recognized that "it is surely unexceptional" that the Takings Clause does not require compensation when an owner's intended uses for property are frustrated by those "existing rules or understandings." *Id.* Just like the client's expectation of personally enjoying IOLTA interest, his expectation of denying others the benefits of his deposited principal is merely "unilateral" because it is inconsistent with the plain implications of the IOLTA rules and the terms of the IOLTA deposit contracts between lawyer and bank.

Another fundamental problem with respondents' "right to deny benefits" argument is that client-depositors can no more take credit for IOLTA-produced benefits

than they can establish IOLTA-produced economic burdens. Because their individual deposits are unable by themselves to generate income, it is as intellectually dishonest for those depositors to take credit for producing IOLTA interest as it is for them to complain of economic injury on the ground that something of value was "taken" from them. In short, under any commonly understood notion of causation, the benefits produced by IOLTA pooling are attributable to the government's creativity rather than the economic power of any given client's deposited principal. This governmental creativity, embodied in the IOLTA programs of every state, is clearly both the but-for and sole proximate cause of the profound benefit to the states' pursuit of equal justice under the law.⁴

Even when "existing rules and understandings" support a right to exclude others from property, such a right

⁴ A helpful analogy to patent law suggests itself here. Although a patent grants an inventor the right to exclude others from making, using, selling, or otherwise benefitting from the invention (unless they pay for those benefits), the patent also defines what is still open to other inventors. *Markman v. Westview Instruments, Inc.*, 116 S.Ct. 1384, 1387 (1996). A subsequent inventor may still receive the benefits of his invention to the extent that it does not infringe on the patent holder. The only "shortcoming" of this analogy is that, unlike the patent holder, the client did nothing creative by making a nominal or short-term deposit into a lawyer trust account. The state, however, did do something creative – it "invented" the IOLTA program. Thus, since the benefits of the program are far more attributable to the inventiveness of IOLTA than to the meager deposits of clients, it follows that those clients have little claim to deny to anyone else the benefits of the state's invention.

normally presupposes an interference somewhat equivalent to a traditional trespass. See, e.g., *Dolan v. City of Tigard*, 512 U.S. 374 (1994) (ruling that a city's effort to coerce a landowner into granting pedestrians an easement across her lot was a compensable taking); *United States v. Causby*, 328 U.S. 256, 266 (1946) ("Flights over private land are not a taking unless they are so low and so frequent as to be a direct and immediate interference with the enjoyment and use of the land."). But where is the interference with a client's principal? To recognize a right to deny others any benefits derived from one's property, at least in the absence of some substantial trespass, would lead to absurdities. For example, a whole neighborhood might benefit economically from governmental regulations designed to preserve aesthetics and, consequently, high property values. Could a sloppy homeowner use the Takings Clause to frustrate government efforts to coerce uses of his property that increase the property values of others? If a city earned revenue by conducting public tours of a unique historical area, or produced economic benefits for local hotels and restaurants because of the tourists drawn to the city by such historical tours, could the owner of an architecturally significant building in that historic area raise the Takings Clause in an effort to deny others from enjoying benefits due in some small part to governmental exploitation of his property? Absent a requirement of some substantial interference with property, of the type associated with a traditional trespass, respondent's argument has no stopping point. And if respondents' proposition makes no sense in the context of government uses of *real* property, it makes even less sense in the context of governmental

uses of *personal* property, which the state has much greater power to regulate in the legitimate exercise of its police powers for the common good. See *Lucas*, 505 U.S. at 1027-28. And, if possible, it makes still less sense in the context of *intangible* personal property, such as a client's alleged property "right" to deny others the benefits of the client's principal.

Additionally, the Takings Clause is simply not offended by every state regulation that fosters a beneficial "use" of property which the owner finds undesirable, any more than it is by every regulation that imposes on the owner some detrimental harm. See, e.g., *Lucas*, 505 U.S. at 1017-18 ("our usual assumption [is] that the [state] is simply adjusting the benefits and burdens of economic life in a manner that secures an average reciprocity of advantage to everyone concerned") (citations omitted), at 1027 ("the property owner necessarily expects the use of his property to be restricted, from time to time, by various measures newly enacted by the state in legitimate exercise of its police powers"), and at 1027-28 ("And in the case of personal property, by reason of the state's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulation might render his property economically useless"); *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922) ("Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law."). Furthermore, this Court has specifically recognized that a property owner can be coerced to tolerate uses by others of his property that are much more direct, much more substantial, and much less voluntary

than the "use" complained of here. See, e.g., *Pruneyard v. Robbins*, 447 U.S. 74 (1980) (holding that it was not a compensable taking for state law to require that owners of private shopping centers tolerate nondisruptive protest activities on their property). Indeed, any "right" to deny others a beneficial use of property is one that often has been restricted for the common good – i.e., for the benefit of others – even to the chagrin of the property owner. Thus, this Court has never found a compensable taking in laws that deny owners of businesses, restaurants, hotels, and other commercial establishments, the right to exclude others from their property based on race, ethnicity, religion, gender, handicap, etc., even in those cases where the property owner might subjectively suffer some indignity at being required to tolerate the particular use. In short, although respondents arguably point to a governmental "use" of a depositor-client's principal, it is a use that hardly constitutes a compensable taking.

A final flaw fatal to respondents' "right to deny beneficial use" argument is that respondent Summers has nowhere asserted how the IOLTA program has specifically denied him that "right." The creation of a lawyer trust account, in most cases, is a voluntary decision made mutually by lawyer and client. State coercion simply does not enter the picture. Indeed, it is often desirable for both lawyer and client to provide a means for the convenient transfer of funds from client to lawyer for those periodic costs incurred by the lawyer while representing client's legal interests. In short, no law mandates that clients maintain an account that is independently incapable of bearing interest, or even that clients maintain a lawyer trust account at all. Moreover, for those clients who have

decided voluntarily to deposit funds into such an account, ethical considerations require that the principal be available to the client on demand. For these reasons it is surely possible, for clients who so desire, to exercise whatever "right" may exist to deny the state's poor the benefits of the "few dollars and some-odd cents" attributable to an IOLTA program's "use" of their principal.

At bottom, this alternative argument of respondents ("I have the right to *deny others* the benefits of my principal") is little more than a recharacterization of its primary argument ("I have the right to *enjoy* the benefits of my principal") with all its attendant flaws. One unique accomplishment of the recast alternative argument, however, is to reveal the true motive underlying this suit – the frustration of states' grass-roots efforts to ensure all state citizens equal access to the state's judicial system, perhaps because the legal agendas of the poor typically differ from those of respondents. That respondents would "kill the IOLTA goose that lays the golden egg" shows just how little they care about any given client's ability to benefit from IOLTA interest. Indeed, respondents' "if I can't have it, nobody can" argument recalls perhaps the oldest recorded adjudication of ownership in the books – King Solomon's Old Testament decision regarding which of two claimants had the superior claim to a baby. I Kings 3:16-28. After one party agreed to Solomon's suggestion to "split the baby," the King wisely decided that the other party possessed the superior claim. In the same way, respondents here would rather "split the IOLTA baby" than permit the states – *i.e.*, the true "parents," whose creativity gave birth to IOLTA programs with their attendant benefits – to enjoy their offspring. More telling

evidence of the inferiority of respondents' property claims cannot be found.

III. The Expansive View of Property Recognized by the Fifth Circuit, and Urged by Respondents, Substantially Intrudes on States' Ability to Administer Business Which Is Uniquely That of the State.

A decision that IOLTA interest is the property of the client-depositor will have widespread negative ramifications for states' efforts to conduct efficiently that which is uniquely state business. IOLTA programs, of course, are just such an effort – an effort to ensure the equality of justice in state courts. This Court has often recognized the magnitude of a state's interest in the administration of its own justice system. *Gregory v. Ashcroft*, 501 U.S. 452, 472 (1991); *Gentile v. State Bar of Nevada*, 501 U.S. 1030, 1075 (1991). Indeed, in many situations, this Court has issued the states a constitutional *mandate* to ensure equal justice for the poor. *M.L.B. v. S.L.J.*, 117 S.Ct. 555, 559-64 (1996). In light of these significant state interests and obligations, this Court should require a much stronger showing of a property interest than exists in this case before reading the Constitution to wreak havoc with all fifty states' creative efforts to improve the administration of justice in state courts.⁵

⁵ Affirmance of the Fifth Circuit's holding will not only negatively impact states' efforts to improve the delivery of justice to the poor, it could also have an impact on states' efforts to economically operate state prisons. Many states provide for prisoners to keep nominal amounts of money in trust accounts in order to purchase things from the prison commissary, but

This Court has been especially sensitive to state interests in its Takings Clause jurisprudence. *See, e.g., Lucas*, 505 U.S. at 1017-18 ("our usual assumption [is] that the [state] is simply adjusting the benefits and burdens of economic life in a manner that secures an average reciprocity of advantage to everyone concerned.") (citations omitted), at 1027 ("the property owner necessarily expects the uses of his property to be restricted, from time to time, by various measures newly enacted by the State in legitimate exercise of its police power."), and at 1027-28 ("And in the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, he ought to be aware of the possibility that new regulation might render his property economically useless"). Indeed, a fundamental precept of this Court's Fifth and Fourteenth Amendment jurisprudence is that constitutionally protected interests in "property" are defined in large part by reference to state law. *See, e.g., Roth*, at 577; *Lucas*, at 1030. Implicit in this precept is that the creation of property rights is a matter of substantial state concern. This is especially significant in the present case because, through IOLTA programs such as the one at issue, states clearly intended to create property rights and, just as clearly, intended to vest those rights in a particular nonprofit foundation. In other

prison security concerns foreclose prisoners having access to large amounts of money. Consequently, the individual prisoner accounts are usually too small in amount to earn interest. When the individual prisoner accounts are pooled, however, there is interest generated that states often funnel back into the prison system. States' continued ability to enjoy this source of prison funding also hinges on the outcome in this case.

words, at the very point in time when states' IOLTA creativity produced an expectation of someone enjoying interest, the states declared that the beneficiary would be the IOLTA nonprofit foundation. How can there be a "taking" when the property was the IOLTA foundation's to begin with? How ironic it was for the Fifth Circuit to justify its dramatic incursion into state affairs by relying on a highly general rule of state law ("interest follows principal") while blindly ignoring the specific – and obvious – state intent to vest the legitimate claim of entitlement to IOLTA interest in the nonprofit IOLTA foundation.

At a time when governmental institutions across the land – both state and federal – are routinely criticized for economic waste and bureaucratic inefficiency, it is not only ironic but revealing that an organization with the leanings of the Washington Legal Foundation would mount such an attack on a creative state-based approach to reducing the banking costs associated with the maintenance of lawyer trust accounts, a cost savings that is directed toward improving the quality of justice available to state citizens in state courts. Indeed, the posture of this case indicates that respondents care more about scuttling IOLTA programs nationwide than they care about recovering any given client's "few dollars and some-odd cents." Of course, if respondents get their wish, those clients with deposits in IOLTA accounts will still earn zero on their "investment." At bottom, this lawsuit is less about who owns the IOLTA interest than how it is spent. And fundamental principles of federalism counsel against using the Constitution to frustrate how the state chooses to spend money that it has generated through its

own creativity. Whether IOLTA interest is spent to provide equal access to the courts for the poor or used to help state governmental entities defend suits sounding in constitutional tort should not matter. And, in the eyes of the Constitution, it does not matter. This Court, therefore, should deny respondents' attempt – and deter future litigants' attempts – to distort the Takings Clause in a way that facilitates substantial intrusions on legitimate state efforts to administer affairs that are fundamentally those of the state.

CONCLUSION

For all the reasons stated in this *amicus curiae* brief, the Conference of Chief Justices respectfully urges this Court to render a decision in favor of the Petitioners, and thereby give the states the freedom they desire to pursue equal justice under the law in state court for all state citizens.

Respectfully submitted by:

CHARLES ALAN WRIGHT
727 East Dean Keeton St.
Austin, Texas 78705
(512) 471-7188

*BRIAN J. SERR
1400 South 5th St.
P.O. Box 97288
Waco, Texas 76798-7288
(254) 710-3611

Attorneys for Amicus Curiae

**Counsel of Record,
Member of the Bar
of this Court*

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

HON. THOMAS R. PHILLIPS, *et al.*,
Petitioners,
v.

WASHINGTON LEGAL FOUNDATION, *et al.*,
Respondents.

**On Writ of Certiorari to the United States
Court of Appeals for the Fifth Circuit**

**BRIEF OF THE AMERICAN ASSOCIATION
OF RETIRED PERSONS AND
LEGAL COUNSEL FOR THE ELDERLY
AS AMICI CURIAE
URGING REVERSAL OF THE JUDGMENT BELOW**

Of Counsel:
Bruce Vignery
Michael R. Schuster
American Association
of Retired Persons
(202) 434-2060
J. Allen May
Legal Counsel for the
Elderly
601 E Street, N.W.
Washington, D. C. 20049
(202) 434-2120

John H. Pickering*
Wilmer, Cutler & Pickering
2445 M Street, N.W.
Washington, D. C. 20037
(202) 663-6200

**Counsel of Record*

Counsel for Amici Curiae

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INTEREST OF AMICI CURIAE¹

The American Association of Retired Persons (AARP) is a nonprofit membership organization of more than 30 million persons aged fifty and older that is dedicated to addressing the needs and interests of older Americans. In representing the interests of its members, and to promote the social welfare, AARP seeks: (a) to enhance the quality of life for individuals as they grow older; (b) to promote independence, dignity, and purpose for individuals as they grow older; and (c) to improve the image of aging.

Older persons are substantial consumers of legal services. Two federal public programs augment private attorney services and help supply needed assistance. The Older Americans Act (OAA) offers grants-in-aid to the states to provide services and advocacy to older persons. One advocacy component is Title III legal services. According to an Administration on Aging Report, Title III legal services programs delivered 1.4 million hours of legal assistance in 1995. Unlike Title III, the Legal Services Corporation (LSC) funds needs-based programs for low-income persons irrespective of their ages. The debate over public funding of Title III and LSC programs is ongoing, but even the harshest critics cannot deny that Title III and LSC programs have assisted many thousands of older persons with their legal problems over the years.

¹ In compliance with Rule 37.6 of this Court, amici curiae, AARP and LCE, state that no counsel for any party authored this brief in whole or in part, and that no person or entity, other than these amici curiae, their members or their counsel, made a monetary contribution to the preparation or submission of this brief.

The parties have consented to the filing of this brief, and their letters of consent are on file with the Clerk.

In recognition of the significant need of the older population for legal services, and cognizant that, as a practical matter, low-income older persons have nowhere else to turn for legal assistance, AARP has consistently supported both the Title III and LSC programs. Both of these federally funded legal assistance programs also receive Interest On Lawyers Trust Accounts (IOLTA) funds. AARP also advocates for adequate funding and support for legal assistance programs at the state level.

There is no reason to believe that older persons' needs for legal assistance will diminish in the years ahead. The numbers of persons 60 years of age and older are growing and the percentage of older persons in the total population is increasing as well. Because legal assistance is necessary when planning one's personal affairs, and is often required to obtain basic necessities such as health care, in-home support services, protective services, and benefits from programs such as Social Security, Supplemental Security Income (SSI), and Medicare, the need for legal services will rise along with the population increase. As the leading organization for older persons in this country, AARP has considerable interest in ensuring that older persons' needs for legal assistance are met. AARP files this brief in support of Petitioners because IOLTA programs have played a vital role in filling gaps in serving the need of older persons for legal assistance.

The other *amicus*, Legal Counsel for the Elderly, Inc. (LCE), is a non-profit organization incorporated in the District of Columbia, which is sponsored by the AARP Foundation and AARP. It is dedicated to providing legal services to low and moderate income older persons in the District of Columbia by training and educating others concerning the legal rights of older persons, and by testing methods of providing free and low cost legal and advocacy

services to older persons. LCE yearly provides free and reduced fee legal services to over 7,000 residents of the District of Columbia, including residents of nursing homes and group homes.

LCE receives funding from a variety of sources including the District of Columbia Bar Foundation. The D. C. Bar Foundation is an organization that receives most of its funds through the IOLTA program established by order of the District of Columbia Court of Appeals, the District's highest court, in the exercise of its supervisory authority over the District of Columbia Bar. LCE has been a grant recipient of the D. C. Bar Foundation since its inception. LCE utilizes funds received from the D. C. Bar Foundation to provide low-income older people with legal assistance in the areas of protective services, guardianships, conservatorships, powers of attorney, and related matters for persons with diminished capacity. LCE is also involved on an ongoing basis with many other legal service providers, and LCE coordinates its activities and shares expertise with such legal services providers locally and nationally that also receive significant funding from IOLTA programs. Thus, LCE has a direct interest in this matter because of its funding and that of the organizations with which it collaborates.

SUMMARY OF ARGUMENT

The decision by a panel of the court below strikes down the innovative IOLTA program -- a program developed by the bench and bar to fund legal services for the poor -- which has previously been upheld by all of the courts, both federal and state, that have considered the IOLTA program.

The panel below did so on the premise that interest follows principal. However, in so doing, the panel failed to appreciate the reality that here there is no interest to follow principal and also failed to follow the law of Texas to that effect as declared by the Texas Supreme Court. In addition, the panel decision failed to conduct the analysis required by this Court's taking clause jurisprudence, and misapplied this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980).

Properly understood, the IOLTA programs do not create any property interests in individual clients, and even if property interests are indirectly created by the pooled IOLTA accounts, there is no taking under the analysis required by *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, *reh'g denied*, 439 U.S. 883 (1978), and subsequent cases.

The conclusion that there is no property and no taking leaves no basis for Respondents' other claims: (1) that Respondents are deprived of the right to exclude others from benefiting from their property,² and (2) that their First

^{2/} See Respondents' Memorandum in Response to the Petition at p. 5, n. 2.

Amendment rights are violated. These claims were not passed on below nor presented by the petition. They should, nevertheless, be considered and rejected by this Court under the jurisprudential standards governing Rule 14.1(a) of this Court, as explained in *Yee v. City of Escondido*, 503 U.S. 519, 533-38 (1992).

This case meets the two-prong test of *Yee*. First, this is a "most exceptional" case because it involves the validity of IOLTA, a matter of great importance to our justice system. Endorsed by the Conference of Chief Justices and the American Bar Association, IOLTA programs have been adopted in every state and the District of Columbia, usually by order of the highest court of the jurisdiction, to provide much needed funds to meet the legal needs of the poor. The need for IOLTA continues to grow as public funding for legal services is cut back and as various restrictions are imposed on the use of the funds that are available. The decision below, which departs sharply from the many federal and state court decisions upholding IOLTA, casts a cloud of uncertainty over IOLTA that can and should be resolved by this Court without further litigation.

This need for resolution brings into play the second prong of the *Yee* test -- "where reasons of urgency or of economy suggest the need to address the unrepresented question in the case under consideration." See 503 U.S. at 535. The two additional claims of Respondents come within this second part of the *Yee* test -- they are closely related to, indeed they are dependent on, Respondents' core taking claim; they fall if that core taking claim is rejected as every court had done until the decision below. Accordingly, in the interest of justice and the conservation of scarce judicial and

legal resources, these additional, unrepresented claims of Respondents should be considered and rejected along with Respondents' basic taking claim as they were by the First Circuit in *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962 (1st Cir. 1993).

ARGUMENT

I. THE DECISION BELOW IGNORES REALITY AND THE LAW OF TEXAS BY "CREATING" PROPERTY WHEN NONE EXISTS.

Under long-standing ethical rules, lawyers have been required to keep funds held for clients in demand deposit accounts, which are kept separate from the lawyers' own funds. These demand deposit accounts for clients, commonly called "trust funds", did not produce interest for clients because banks did not pay interest on demand deposits. Instead, banks enjoyed the use of the funds and kept the interest produced by the funds.

This situation changed in 1981 when, for the first time, banking regulations permitted payment of interest on demand checking accounts, the so called Negotiated Orders of Withdrawal, or NOW, accounts. But, under the reality of the way banks do business, no interest would be paid on individual client deposits that were nominal in amount or held for such a short time that the banks' charges would exceed the interest. However, if such nominal or short-term deposits for individual clients could be pooled in a lawyer's trust account, they could produce net interest in excess of the bank charges. Realizing this possibility, leaders of the bench and bar developed the concept of the IOLTA program by

which the interest formerly kept by the banks -- and that was never available to clients -- could be shifted from the banks and used to meet the pressing need for funding legal services for the poor. This concept was endorsed by the Conference of Chief Justices and the American Bar Association, and has been adopted by all 50 states and the District of Columbia, usually by order of the jurisdiction's highest court.³ Thus, the Texas IOLTA program attacked here was created by order of the Supreme Court of Texas pursuant to its authority to regulate the legal profession. The Texas order, which is typical of the orders establishing other IOLTA programs:

(a) Requires that a lawyer who receives individual "client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time" to deposit them "in a separate interest-bearing demand account" (the so-called IOLTA account),⁴ and

(b) Further provides that such nominal or short-term individual client funds may be deposited in an IOLTA account only if "such funds considered without regard to funds of other clients which may be held by the attorney. . . , could not reasonably be

^{3/} An IOLTA program has been approved in Indiana, but is not yet operational.

^{4/} *Washington Legal Foundation v. Texas Equal Access to Justice Foundation* ("Texas Equal Access"), 94 F.3d 996, 999 (5th Cir. 1996), *reh'g and suggestions for reh'g en banc denied*, 106 F. 3d 640 (5th Cir.), *cert. denied*, 117 S. Ct. 2514 (No. 96-1766), and *cert. granted in part sub. nom. Phillips, et al v. Washington Legal Found., et al*, 117 S. Ct. 2535 (1997) (No. 96-1578).

expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs, which would be incurred in attempting to obtain interest on such funds for the client." *See Texas Equal Access*, 94 F.3d at 999.

The premise of the IOLTA program thus is to take nominal or short-term funds of individual clients that cannot produce interest separately, and aggregate them in a pooled trust account with like funds of other clients so that they will produce a net amount over bank charges.

The decision by a panel of the court below did not question this basic premise of the IOLTA program, but viewed it as an unsuccessful attempt at "alchemy". *See id.* at 1000. The panel then proceeded to create "something from nothing" itself by asserting that interest "is a two-part process" in which "a property interest attaches the moment interest accrues, from which the bank then deducts its charges from the depositor's account." *Id.* at 1003. The panel did not explain how this assumed "property interest" has any value when it would be offset by the bank charges, as it would be without IOLTA. An individual depositor of nominal or short-term funds could not get his or her "accrued property interest" without paying the bank's charges, which not only consume any interest that might be produced, but may even consume the principal of the deposit itself over time.

Six judges of the court below dissented from the denial of the suggestions for rehearing *en banc* of the panel decision, and four of them filed a dissenting opinion that strongly criticized the panel's decision in almost every respect. 106 F.3d 640 (5th Cir. 1997). In particular, the "two-part process" used by the panel to create a "property interest" was flatly called "simply wrong" (106 F.3d at 643-44):

The panel attempted to avoid this reality [i.e., that the clients had no property to be taken] by claiming that a bank assigns interest to a depositor in a two-part process. *See Washington Legal Fdn.*, 94 F.3d at 1003. According to the panel, a bank attributes interest to an account prior to deducting any of its fees. *Id.* From this, the court concluded that "a property interest attaches the moment that the interest accrues. . . ." *Id.*

Even if the panel presents an accurate picture of banking practices, however, those practices are beside the point. For purposes of a takings clause challenge, a constitutionally cognizable interest in property does not exist in "earnings" from a deposited fund unless and until those earnings can be distributed as proceeds to the fund's beneficiary. Because IOLTA-eligible funds would never produce interest proceeds, earnings from such funds cannot be distributed to the funds' owners. For this reason, the panel's conclusion that a property interest was created after the first

step in the bank's process of assigning interest is simply wrong.

The panel's two-part process is more than just "simply wrong". In addition to ignoring the reality of banking practices, it fails to give the deference that is due to the order of the Supreme Court of Texas carefully limiting IOLTA deposits to individual client funds which can not "reasonably be expected to earn interest for the client". 94 F.3d at 999. *Cf. Idaho v. Coeur d'Alene Tribe*, 117 S. Ct. 2028 (1997).

The panel below may be correct when it says that, under the law of Texas, interest follows principal, but it ignores the law of Texas -- as declared by the order of the Supreme Court of Texas establishing the Texas IOLTA Program -- when it asserts that there is any interest to follow principal. The IOLTA program does not take anything an individual client could earn on his or her nominal or short-term deposits. That reality completely undercuts the decision below.

II. THIS COURT'S TAKING CLAUSE JURISPRUDENCE ESTABLISHES THAT THERE IS NO TAKING UNDER IOLTA.

A taking clause analysis naturally begins with determining whether there is any property to be taken. As the panel below recognized, "State law defines 'property'", *Texas Equal Access*, 94 F.3d at 1000 (citing *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972)). The panel then proceeded, contrary to the law of Texas, to find property rights to interest in Respondents, even though the Supreme

Court of Texas stated in its order creating its IOLTA program that a client's funds were to be deposited in IOLTA accounts only if "such funds, considered without regard to funds of other clients which may be held by the attorney . . . , could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost[s involved]." *Id.* at 999.

This error of finding a property right that is not recognized by the law of Texas is compounded by the failure of the panel below to conduct a taking analysis under the principles stated in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978), and consistently followed in subsequent cases.⁵ Indeed, *Penn Central* was not even mentioned by the panel below. When the *Penn Central* analysis is performed, it is clear that there is no taking by an IOLTA program.

In *Penn Central*, this Court recognized that its prior decisions on the taking clause had been "unable to develop any 'set formula' for determining . . . [what are] essentially ad hoc factual inquiries, [but] the Court's decisions have identified several factors that have particular significance." *Penn Central* at 124. Those factors were explained as "[t]he economic impact . . . on the claimant", interference "with distinct investment-backed expectations" and the "character of the governmental action". *Id.*

⁵ See, e.g., *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426 (1982); *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 224-25 (1986)

When IOLTA is measured against these three factors, there is no taking:

(A) There is no economic impact on the claimants.

IOLTA does not take any client funds; they remain payable to the client on demand. Nor does IOLTA deprive clients of any interest they could individually derive from deposit of their individual nominal or short-term funds. It is irrelevant that the pooled IOLTA accounts do produce funds, for the taking clause is not triggered by someone's gain, but only by someone's loss. See, *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945).

(B) There is no interference with distinct investment-backed expectations:

Before the creation of NOW accounts, clients had no investment-backed expectations because interest was not paid on demand deposits. This was not changed by IOLTA because the nominal or short-term funds of individual clients that are required to be deposited in IOLTA accounts are not capable of producing interest if deposited by the individual. There is simply no realistic basis for any client to have distinct investment-backed expectations regarding deposits of his or her nominal or short-term funds, because any interest will be offset, indeed the principal itself may even be consumed, by bank charges.

(C) The character of the government action.

As *Penn Central* explains, 438 U.S. at 124:

A "taking" may more readily be found when the interference with property can be characterized as a physical invasion by government, see e.g. *United States v. Causby*, 328 U.S. 256 (1946), than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good.

IOLTA easily passes under this factor. There is no physical invasion of Respondents' property, and IOLTA is a public program created by the states to promote the common good, i.e., to raise badly needed funds to provide access to justice for the poor.

Instead of undertaking an analysis of the *Penn Central* factors, the court below relied on *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980). However, *Webb's* is consistent with *Penn Central* as *Webb's* itself explains. See esp. *Webb's*, 449 U.S. at 163-64. In any event, *Webb's* is also easily distinguishable as next discussed.

III. THIS CASE IS NOT GOVERNED BY WEBB'S FABULOUS PHARMACIES.

Webb's case has no application to the IOLTA programs. It is factually and analytically distinguishable as

every federal and state court considering the matter consistently found until the panel decision below.⁶

There is simply no comparison between the \$1,812,145 deposit which earned interest in excess of \$100,000 that was involved in *Webb's* and the nominal or short-term deposits involved in IOLTA that by definition will not produce interest for individual clients. The creditors in *Webb's* had distinct investment-backed expectations and the action of the state in taking the interest in addition to a statutory fee had an adverse economic impact on them. Moreover, the nature of the state action was different in *Webb's*; it was not an effort to adjust "the benefits and burdens of economic life to promote the common good. . . . Rather, the exaction is a forced contribution to general government revenues, and it is not reasonably related to the costs of using the courts." 449 U.S. at 162-63 (citation omitted). Moreover, "[n]o police power justification is offered for the deprivation." *Id.*

This Court was also careful to stress that its decision in *Webb's* was limited to "the narrow circumstances of this case", *id.* at 164, circumstances that have no application to IOLTA as the panel below erroneously assumed. The confusion below is illustrated by the assertion that other courts have found *Webb's* "inapposite because of the

⁶ See e.g., *Cone v. State Bar of Florida*, 819 F.2d 1002 (11th Cir.), cert. denied, 484 U.S. 917 (1987); *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962 (1st Cir. 1993); *Carroll v. State Bar*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (Cal. App. 4th Dist.), cert. denied sub. nom. *Chapman v. State Bar of California*, 474 U.S. 848 (1985).

difference in size between the deposit in *Webb's* and the funds eligible for deposit in IOLTA accounts." *Texas Equal Access*, 94 F.3d at 1001. That completely misses the point.

The critical difference is not the size of a deposit but whether it can produce interest. Interest was produced on the large deposit in *Webb's*, but cannot reasonably be expected on the nominal or short-term funds of individual clients subject to IOLTA. The taking clause protects even nominal amounts, but it does not protect the non-existent interest that nominal or short-term deposits of individual clients are unable to produce unless pooled with other client funds in an IOLTA account.

IV. THE MATTERS LEFT OPEN BELOW SHOULD BE RESOLVED BY THIS COURT IN THE INTEREST OF JUSTICE.

The other challenges raised by Respondents against IOLTA -- that were left open below and are not presented by the petition -- should nevertheless be decided by this Court in the interest of justice. Ordinarily, of course, this Court will consider only questions "set out in the petition, or fairly included therein . . .". Sup. Ct. R. 14.1(a). However, this rule is prudential only in cases coming from the federal courts and may be disregarded in "the most exceptional cases. . . where reasons of urgency or of economy suggest the need to address the unrepresented question in the case under consideration." *Yee v. City of Escondido*, 503 U.S. 519, 535 (1992) (citation omitted).

This is one of those "most exceptional cases. . . where reasons of urgency or of economy" justify disregarding the prudential limitation of Rule 14.1(a).

IOLTA is a program of great public importance. Endorsed by the Conference of Chief Justices and the American Bar Association, and adopted in every state and the District of Columbia, it provides badly needed funds for the poor to have access to justice. The interest formerly enjoyed by banks is now used to fund legal service providers who desperately need it to replace the cutbacks in public funds for legal services and the restrictions placed on the use of those public funds.

Despite the innovative and beneficial nature of the IOLTA programs, and their wide acceptance, these programs have been under attack, almost from the beginning, often by Respondent Washington Legal Foundation, in federal and state courts across the nation, from Florida to California and from Massachusetts to Texas, without success until the panel decision below.⁷

⁷ The constitutionality of IOLTA programs has been upheld by the 1st and 11th Circuits. See *Cone v. State Bar of Florida*, 819 F.2d 1002 (11th Cir.), cert. denied, 484 U.S. 917 (1987), and *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962 (1st Cir. 1993).

The courts of Arkansas, California, Florida, Massachusetts, Minnesota, New Hampshire, Utah and Washington have also explicitly ruled that IOLTA is constitutional and does not involve any taking of property. See *In the Matter of Interest on Lawyers' Trust Accounts*, 283 Ark. 252, 675 S.W. 2d 355 (1984); *Carroll v. State Bar of California*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (Cal. App. 4th Dist.), cert. denied sub nom. *Chapman v. State Bar of California*, 474 U.S. 848 (1985); *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981); *Petition by Massachusetts Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715

That panel decision, which sharply departs from all prior holdings, has cast a cloud of uncertainty over IOLTA that should be resolved, once and for all, by this Court for reasons of urgency and economy and in the interest of justice and our proud goal of "equal justice under law".

Having sustained Respondents' taking claim, the panel below did not pass on Respondents' additional claims that the Texas IOLTA program (1) deprived Respondents of the right to exclude others from benefiting from their property and (2) violated their First Amendment rights.

These additional claims are closely related to, indeed they depend upon, Respondents' core claim that their property is being taken against their will. If that core claim is rejected -- as we urge this Court to do, and as every court has done before the decision below -- these additional claims also fall as the First Circuit held in the *Massachusetts Bar Foundation* case. 993 F.2d 962. If there is no property being taken, Respondents have no claim that others are benefitting from their property; likewise Respondents have no First Amendment claim that their property is being used against their will to support causes which they oppose.

Accordingly, for reasons of urgency and economy and in the interest of justice, the Court should consider and

(1985); *Petition of Minnesota State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); *Petition of New Hampshire Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258 (1982); *In the Matter of Interest on Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); and, *In the Matter of Adoption of Amendments to CPR DR 9 102 IOLTA*, 102 Wash. 2d 1101 (1984).

reject these additional claims of Respondents along with their core taking claim.

CONCLUSION

For the reasons stated herein, and in the briefs of Petitioners and other supporting *amici*, the decision below should be reversed and the constitutionality of the IOLTA programs should be upheld.

Respectfully submitted,

Of Counsel:

Bruce Vignery

Michael R. Schuster

American Association

of Retired Persons

(202) 434-2060

J. Allen May

Legal Counsel for the

Elderly

601 E Street, N.W.

Washington, D. C. 20049

(202) 434-2120

John H. Pickering*

Wilmer, Cutler & Pickering

2445 M Street, N.W.

Washington, D. C. 20037

(202) 663-6200

*Counsel of Record

Counsel for Amici Curiae

AUG 25 1997

In The
Supreme Court of the United States CLERK

October Term, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A.
GONZALEZ, HON. JACK HIGHTOWER, HON.
NATHAN L. HECHT, HON. LLOYD DOGGETT, HON.
JOHN CORNYN, HON. BOB GAMMAGE, HON. CRAIG
T. ENOCH, HON. ROSE SPECTOR, TEXAS EQUAL
ACCESS TO JUSTICE FOUNDATION, AND
W. FRANK NEWTON, IN HIS OFFICIAL CAPACITY
AS CHAIRMAN OF THE TEXAS EQUAL
ACCESS TO JUSTICE FOUNDATION,

v.

Petitioners,

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

On Writ Of Certiorari To The
United States Court Of Appeals
For The Fifth Circuit

BRIEF OF AMICUS CURIAE AMERICAN BAR
ASSOCIATION IN SUPPORT OF PETITIONERS

JEROME J. SHESTACK*
President
American Bar Association
750 N. Lakeshore Drive
Chicago, Illinois 60611
(312) 988-5000

JEROLD S. SOLOVY
BARRY LEVENSTAM
PAUL M. SMITH
NORY MILLER
JEFFREY I. RYEN
JENNER & BLOCK
601 Thirteenth Street, N.W.
Washington, D.C. 20005
(202) 639-6000

Attorneys for Amicus Curiae

August 25, 1997

* *Counsel of Record*

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INTEREST OF AMICUS CURIAE¹

The American Bar Association ("ABA") is a voluntary membership organization of the legal profession dedicated to the promotion of a fair and effective system for the administration of justice. Its membership includes approximately 342,000 lawyers.

The ABA has supported the creation of IOLTA (Interest on Lawyer's Trust Accounts) programs in every state and in the District of Columbia for almost two decades. It views IOLTA as an integral component in the funding of civil legal services to the indigent. The ABA formed an Advisory Board and Task Force on IOLTA in 1981. Two years later the ABA Board of Governors officially approved state-authorized IOLTA programs. Meanwhile, the ABA Standing Committee on Ethics and Professional Responsibility reviewed the ethical implications of IOLTA programs and concluded that participation in state-authorized IOLTA programs was consistent with lawyers' professional and ethical responsibilities. The ABA has continued to support the adoption of IOLTA programs in every state, and in 1988, the ABA House of Delegates specifically resolved to encourage states to adopt or convert to mandatory IOLTA programs.

¹ The parties have consented to the submission of this brief. Their letters of consent have been filed with the Clerk of this Court. Neither this brief nor the decision to file it should be interpreted to reflect the views of any judicial member of the American Bar Association. No inference should be drawn that any member of the Judicial Division Council has participated in the adoption of or endorsement of the positions in this brief. This brief was not circulated to any member of the Judicial Division Council prior to filing.

The net income collected through each IOLTA program is distributed as grants. According to a survey conducted by the ABA Commission on IOLTA, approximately 90 percent of IOLTA grants in the United States support either the provision of direct civil legal services or pro bono legal services to the poor. Some IOLTA grants fund programs related to the administration of justice, such as alternative dispute resolution programs, young lawyer special public service projects, victim services programs, court-appointed special advocate programs, and *pro se* litigation programs. In addition, some IOLTA grants are provided for legal education and loans and scholarships for law students.

IOLTA programs are a critical part of the indigent civil legal services delivery system in the United States and have become even more critical after the budget of Legal Services Corporation, the entity providing federal funding for legal services to the poor, was reduced by 30 percent. A survey conducted in 1992 by Justice Howard Dana of the Maine Supreme Court found that IOLTA funds provided approximately 25 percent of all funding for staffed legal services programs. Between 1983 and 1993, according to a Legal Services Corporation survey, IOLTA programs contributed \$405.8 million to Legal Services Corporation-funded programs. In addition, according to a survey conducted by the ABA Center for Pro Bono in 1991, IOLTA programs fund approximately 26 percent of the budgets for bar association-sponsored pro bono programs. Today, IOLTA programs represent the second largest funding source for the delivery of civil legal services to the poor in this country. The ABA is strongly committed to ensuring that all people in this

country receive needed legal services and have access to the nation's civil justice system. Therefore, the ABA has a significant interest in the future availability and effectiveness of IOLTA programs.²

In addition, the ABA operates a Commission on IOLTA and an IOLTA Clearinghouse which monitor and provide information about the operation of IOLTA programs across the country. The ABA is therefore uniquely qualified to provide this Court with a full understanding of IOLTA programs in Texas and throughout the nation.

² Two of the twelve goals that the ABA has adopted reflect its interest in ensuring the availability and effectiveness of IOLTA programs: Goal I - To promote improvements in the American system of justice; Goal II - To promote meaningful access to legal representation and the American system of justice for all persons regardless of their economic or social condition.

STATEMENT

The National Conference of Chief Justices endorsed and encouraged the development and implementation of IOLTA programs by resolution in February 1979. IOLTA-type programs were first implemented in Australia in the 1960s, and soon spread to Canada, New Zealand, and several African countries. All fifty states, either through the state's highest court or the state legislature have approved IOLTA programs, as has the highest court of the District of Columbia. Fifty of these programs are in operation.³ In this country, the programs are premised on specific banking laws and regulations that do not permit many client deposits with lawyers to earn income, but do permit banks to pay interest if those same deposits are structured as an IOLTA account.

There are essentially two types of situations in which clients deposit funds with lawyers. One is when a client finds it convenient to have an attorney hold funds for generally short periods of time in connection with specific legal undertakings. For example, clients often deposit real estate closing costs with their lawyers a day or two before the closing is scheduled. Clients also may arrange for settlement proceeds to be paid to their lawyers who then transfer the proceeds to their clients by check. Buyers and sellers of real property also frequently arrange to have the seller's lawyer, rather than the seller

³ An IOLTA program has been approved in concept by the Supreme Court of the last remaining state, Indiana, but the program is not yet operational. Of the programs currently in operation, 27 are mandatory, 20 permit attorneys to affirmatively opt out of the program, and 3 are voluntary. See attached Appendix.

or other agent, hold the buyer's earnest money deposit between offer and closing. The other type of situation in which clients deposit funds with lawyers is to satisfy a lawyer's request for advance payment as part of their business arrangement, such as refundable retainers or pre-payments of court and litigation expenses.

Traditionally, most lawyers placed these client deposits in a pooled demand account separate from their own funds.⁴ The funds were therefore available on demand when the client needed them but did not, under the banking laws applicable in most states before 1980, earn interest. The banking institutions had full use of these funds while they were deposited and retained all income derived from that use.⁵

⁴ Separation of client funds from the lawyer's own funds has been imposed by most states as an ethical requirement. See, e.g., ABA Model Rules of Professional Conduct ["ABA MRPC"] R.1.15 (1997).

⁵ An exception was possible in the relatively unusual situation in which a client did not need immediate access to the funds and the amount of money was large enough or length of time was long enough to generate more interest than needed to cover administrative costs. With the client's agreement, the lawyer could place these funds in a savings or time account which did pay interest but did not guarantee immediate access. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 348, 688 A.B.A.J. 1503 (1982) ["ABA Formal Op. 348"]. Under these circumstances, clients would have to bear additional costs for services rendered by the bank or the lawyer in accounting for the interest, remitting it to the client, and generating tax forms for both the client and the Internal Revenue Service. Lawyers are not permitted to deduct these costs from the interest generated, *see id.*, but they are permitted to bill clients for reasonable administrative expenses. See Carroll

In 1980, Congress passed the Consumer Checking Account Equity Act, codified at 12 U.S.C. § 1832, which for the first time permitted banks throughout the country to pay interest on certain demand accounts. These accounts became known as Negotiable Order of Withdrawal or NOW accounts. Under the statute, NOW accounts are available only to one or more individuals, government agencies, and non-profit philanthropic, religious, educational or political organizations. See 12 U.S.C. § 1832(a)(2); 12 C.F.R. § 204.130. Demand accounts for corporations, partnerships, associations, insurance companies, and the like, continue to pay no interest.

Funds deposited by a fiduciary, such as a lawyer, may be placed in a NOW account only if the beneficiaries are themselves eligible to maintain NOW accounts. See 12 C.F.R. § 204.130(e). Likewise, escrow accounts may be held as NOW accounts only "if the entire beneficial interest is held by individuals or other entities eligible to maintain NOW accounts directly." 12 C.F.R. § 204.130(b)(2). Thus, a lawyer is permitted by federal banking law to place client funds in a NOW account only if the client is an individual, a governmental unit, or a non-profit philanthropic, religious, educational or political organization. As a result, although NOW accounts may provide a useful vehicle in some cases, deposits from clients that are corporations, partnerships, associations, insurance companies and the like, are not, by themselves, eligible.

Further, bank charges are deducted from the funds available in NOW accounts so that most deposits even for

v. State Bar of California, 166 Cal. App. 3d 1193, 1205, 213 Cal. Rptr. 305, 312 (4th Dist.), cert. denied, 474 U.S. 848 (1985).

clients who are eligible for these accounts would fail to earn any income. Thus, as before, in most cases banks alone would enjoy the beneficial use of client deposits.

IOLTA was developed as a method to use the new banking laws to wrest some of this beneficial use away from the banks and, where it was not possible to confer it on the client, use it to fund legal services for the poor and equal access to justice programs.⁶ IOLTA programs take advantage of the provision that permits a non-profit philanthropic organization to maintain a NOW account. Under an IOLTA program, each lawyer or law firm establishes a NOW account for which the interest, less bank charges, is paid to the state's IOLTA organization. Client deposits are pooled in the account, reducing bank charges and generating more net interest. Moreover, because all charges are paid by and all interest is paid to one entity, no costs are incurred for attributing interest or charges to particular clients.⁷ Finally, although NOW accounts in which clients are the beneficiaries are limited to deposits from individuals, governmental units or qualifying non-profit organizations, deposits from every type of client

⁶ In this country, certain bar associations had shown interest in IOLTA programs as early as the 1970s, when NOW accounts were approved for operation in a few states and the Federal Reserve Board of Governors recommended to Congress that such accounts be made available nationally. See *In re Interest on Trust Accounts*, 356 So. 2d 799 (Fla. 1978).

⁷ Neither lawyer nor bank needs to attribute interest or charges to specific deposits because the IOLTA organization receives all interest less all charges. Neither lawyer nor bank needs to generate and send tax forms to each client because the clients exercise no control over the distribution of income from the account. See Rev. Rul. 87-2, 1987-1 C.B. 18; Rev. Rul. 81-209, 1981-2 C.B. 16.

may be placed in an IOLTA account because the sole beneficiary of the income generated by an IOLTA account is a qualifying non-profit organization.⁸

Nonetheless, although all client deposits are eligible to be placed in an IOLTA account under federal banking laws, not all client deposits are eligible to be placed in an IOLTA account under IOLTA rules. Lawyers are required to make a determination whether the client deposit is capable of earning income for the client. In making that determination, the lawyer must consider the amount to be deposited, the length of time it will be held, the likely bank charges, and the likely administrative costs of establishing, maintaining, and complying with tax requirements. Any client funds that can earn more interest in a non-IOLTA account than will be consumed by administrative costs may not be placed in an IOLTA account.⁹

⁸ IOLTA organizations are either bar foundations, independent 26 U.S.C. § 501(c)(3) organizations created to administer IOLTA, or extensions or special programs of the state, state supreme court or state bar.

⁹ In Texas, and a number of other states, lawyers also consider whether the client's deposit could earn more interest if aggregated with other NOW-eligible client deposits in an aggregated account than will be consumed by administrative costs. "If the client funds deposited in an individual or pooled account *can* earn interest above and beyond such costs and charges, and thus, earn a net return to the client in *any* amount, the funds may not be deposited into an IOLTA account." Justices of the Supreme Court of Texas Suggestion of the Appropriateness of a Rehearing En Banc, *WLF v. TEAJF*, No. 95-50160, br. at 6 (5th Cir. Sept. 25, 1996) (explaining the rules governing the Texas IOLTA program challenged here). The Supreme Court of Texas created the Texas IOLTA program and promulgated the rules governing it, see Texas Rules of Court - State, Rules Governing

IOLTA programs were structured to divert income legally from banks to legal services and equal access to justice programs. They were not intended to, and under their rules may not, divert income that could otherwise be earned by a client.¹⁰

No court had ever struck down an IOLTA program on constitutional grounds before the decision below. To the contrary, every other court that has considered the question has rejected arguments that IOLTA programs contain any constitutional infirmities. See, e.g., *Cone v. State Bar of Florida*, 819 F.2d 1002 (11th Cir.), cert. denied, 484 U.S. 917 (1987); *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962 (1st Cir. 1993); *Petition of Mass. Bar Ass'n*, 478 N.E.2d 715 (Mass. 1985); *Carroll v. State Bar of California*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (4th Dist.), cert. denied, 474 U.S. 848 (1985); *Petition of N.H. Bar Ass'n*, 453 A.2d 1258 (N.H. 1982); *Petition of Minn. State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); and *Matter of Interest on Trust Accounts*, 402 So. 2d 389 (Fla. 1981).

the Operation of the Texas Equal Access to Justice Program (West 1996). The additional precaution appears, however, to have little practical application. First, only deposits from individuals or other qualifying clients may be aggregated in a non-IOLTA NOW account. Second, aggregated accounts impose very high administrative costs in addition to the types of costs imposed by individual accounts, because it is necessary to attribute the appropriate proportion of interest and charges to each client and to send individual 1099-INT tax forms for each client to both the client and the Internal Revenue Service.

¹⁰ In Texas, for example, if a lawyer deposits funds in an IOLTA account that do not qualify under these rules, a mechanism exists for reimbursing the client.

SUMMARY OF ARGUMENT

That client funds placed in IOLTA accounts do not earn income for the clients is not the fault of the IOLTA rules; it is the result of the nature of the deposits, the banking laws, and the tax laws. Absent an IOLTA program, these funds would still not generate income for these clients. Indeed, client deposits capable of generating income for the clients are not permitted by state law to be placed in an IOLTA account. Thus, these clients have no legitimate claim of entitlement to income on their deposits under the prevailing law and contractual understandings unrelated to IOLTA programs, and therefore they do not meet the standard required to establish a property interest cognizable under the Fifth Amendment. Pt. IA.

The interest generated on IOLTA accounts does not result from interference with any property rights the clients have in the funds deposited. Therefore, clients cannot premise a claim to IOLTA interest on a right to exclude others from using those funds. Pt. IB.

Neither *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), nor the Texas decision the Fifth Circuit relied on, establish a legitimate claim of entitlement here. Both considered the existence of a property right in interest under the very different circumstances of deposits that would have generated the same income if deposited by their owners. Pt. IIA. The existence or non-existence of a property right turns on just such distinctions in background law as this Court has repeatedly found. See, e.g., *United States v. Willow River Power Co.*, 324 U.S. 499 (1945). Pt. IIB.

Likewise, the fact that an IOLTA account generates interest does not confer a property right to that interest on clients who – wholly apart from the challenged IOLTA rules – are legally or practically incapable of earning interest directly. Clients who have no right to NOW account interest income under the banking laws, or under the bank's contractual terms, do not gain the right to NOW interest income generated in the name of entities subject to different rules. The right to property that comes into existence pursuant to particular laws remains subject to the conditions imposed by those laws. See, e.g., *Dames & Moore v. Regan*, 453 U.S. 654 (1981). Pt. IIC.

The decision below therefore should be reversed.

ARGUMENT

I. CLIENTS HAVE NO CONSTITUTIONALLY COGNIZABLE PROPERTY INTEREST IN THE INCOME GENERATED BY IOLTA ACCOUNTS.

A. Clients Have No Legitimate Claim Of Entitlement To Interest On IOLTA Deposits.

It is long settled that a constitutionally cognizable property interest exists only where there is "a legitimate claim of entitlement . . . as defined by existing rules or understandings that stem from an independent source." *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972).¹¹ That independent source may be state law, *id.*, or

¹¹ Although initially recognized in the context of procedural due process, the test has long been applied in

federal law. See, e.g., *Atkins v. Parker*, 472 U.S. 115 (1985); *Dames & Moore*, 453 U.S. at 674 n.6.

The existing rules and understandings applicable to client deposits in IOLTA accounts make clear that the clients have no "legitimate claim of entitlement" to interest on these deposits. First, many of these clients are prohibited by the banking laws from earning interest on demand accounts because they are not individuals, governmental units, or qualifying non-profit organizations. Second, the deposits placed in IOLTA accounts from clients who do qualify for NOW accounts are not large enough or held for long enough to actually earn any income under the express contractual terms available from the banks. If they were, IOLTA rules in every jurisdiction require the deposits to be placed in a non-IOLTA account.

Thus, nothing is taken from clients and no opportunity to earn income is diverted. Had the clients kept control of their funds and attempted to earn interest income from a bank for the applicable time period by any means available under the law, they would not have been able to do so.¹² In other words, these clients would earn no income on their nominal or short-term deposits

Takings Clause decisions. See, e.g., *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001 (1984); *Webb's Fabulous Pharmacies*, 449 U.S. at 160-61.

¹² If a client eligible for a NOW account deposited his funds into an individual account, at best the client might be able to withdraw the same amount originally deposited when the funds were needed. In most cases, the client could not do even that because part of the original deposit would have been applied to pay bank charges.

whether or not Texas had mandated the IOLTA program. *Accord Cone*, 819 F.2d at 1006. They have no basis therefore in law or mutual understandings on which to stake a legitimate claim of entitlement to the interest income generated when their deposits are placed in an IOLTA account.

B. Clients And Lawyers Have No Legitimate Claim Of Entitlement To IOLTA Interest On Any Other Basis.

Clients also cannot premise a claim to IOLTA interest on a right to control how their funds are used. Whatever constitutionally cognizable right they may have had to exclude others from using these funds was voluntarily relinquished when they deposited the funds with a lawyer.

Nothing in the IOLTA rules or any other law requires any client to deposit money with any lawyer. For example, clients who deposit real estate closing payments with lawyers do so for their own convenience. They are completely free instead to bring their real estate closing payments to the closing itself. Likewise, clients who agree to settlement terms providing for the settlement payments to be collected and distributed by their attorneys do so because it is a mutually acceptable solution to a practical problem. No law requires clients to agree to such terms. They remain free to require that settlement payments be sent directly to them. IOLTA rules and other laws also do not require clients to deposit real estate escrows with an attorney. The choice to use an attorney to hold a real

estate escrow payment rather than the seller or a different third party is made by the parties to the sale.

Similarly, cost advances and refundable retainers are deposited pursuant to the terms of the contract between the lawyer and the client. There may be lawyers who are unwilling to negotiate these terms but that is a choice made by the lawyer, not the state. No client is ever under an obligation to deposit cost or fee advances with a lawyer unless the client voluntarily undertakes to do so.

In other words, clients who deposit funds with their lawyers are in no worse a position than partnerships who deposit money in a bank checking account.¹³ Banks are prohibited by federal law from paying interest on a partnership's checking accounts, even though the funds deposited are used to earn income for the bank. *See* 12 U.S.C. § 1832(a)(2). But once the funds are deposited, the bank is free to use them in any way permitted by law without regard for the partnership's views, so long as it provides the principal on demand. Thus, the bank may invest the funds in ways the partnership thinks improvident. And the bank may loan the funds to an endeavor to which the partners are ideologically and morally opposed.

Such activities have never been thought to implicate constitutional rights because the partnership's inability to control the bank's use of its deposit is not the result of a

¹³ The client is actually in a better position than the partnership because if the client's deposit is capable of earning income while deposited, it cannot be placed in an IOLTA account.

governmental encroachment on its property rights. The partnership's inability to control the bank's use of its deposit is the result of the partnership's decision to deposit the money with the bank. However convenient a checking account may be, and however non-negotiable the terms offered by the bank, opening the checking account is in no way mandatory. The same is true of a client's inability to prevent its lawyer from placing nominal or short-term deposits in an IOLTA account. Although it may be convenient to deposit certain funds with the lawyer, and the terms for depositing advances may not be particularly open to negotiation, the client who wishes to exercise a right to exclude remains free to make different arrangements. Thus, the IOLTA program does not contravene any right the client may have over how its funds are used.¹⁴

¹⁴ Moreover, lawyers required to establish and use IOLTA accounts certainly have no property interest in any IOLTA interest generated because they have no legitimate claim of entitlement to either the funds themselves or to any income generated from the funds. Indeed, lawyers who hold client funds are prohibited from using these funds for their own benefit or even commingling the funds with their own. *See, e.g.*, ABA MRPC Rule 1.15; *see also* ABA/BNA Lawyers' Manual on Professional Conduct 45:109-45:111 (1997). Further, when interest is earned on such funds, lawyers are also forbidden to treat that interest as their own. They are not permitted, for example, to deduct legitimate charges from that interest, even when the charges are for administrative costs incurred in servicing the account or reporting the interest. *See* ABA Formal Op. 348. As discussed *supra* note 5, however, lawyers are permitted to recoup the cost of handling such accounts through normal billing.

II. THE "INTEREST FOLLOWS PRINCIPAL" RULE APPLIED IN INTERPLEADER CASES IS IRRELEVANT TO THESE QUITE DIFFERENT CIRCUMSTANCES.

In concluding that these clients had a property interest in the interest generated by IOLTA accounts, the court below relied on two inapposite decisions: this Court's *Webb's Fabulous Pharmacies*, 449 U.S. 155, and the Supreme Court of Texas' *Sellers v. Harris County*, 483 S.W.2d 242 (Tex. 1972). Both cases determined the ownership of interest on interpleaded funds, which in every relevant sense is wholly unlike the interest at issue here.

A. Interpleaded Funds Differ From IOLTA Accounts In Three Critical Ways.

First, in both *Webb's Fabulous Pharmacies* and *Sellers*, the interpleader was required by state law to deposit the principal in order to avail itself of statutory protection from suit. And, in both instances, the state did not permit the owners of the funds to have access to them until the conclusion of lengthy court proceedings.¹⁵ In *Webb's Fabulous Pharmacies*, the principal was the sale price of a company all of which was claimed by the company's creditors. In *Sellers*, the principal was insurance proceeds that were owed to one of two adverse claimants.

In contrast, the principal in the instant case is composed entirely of client funds that the clients are free to retain and invest themselves but have chosen instead to

¹⁵ See, e.g., *Webb's Fabulous Pharmacies*, 449 U.S. at 164.

deposit with their lawyers, for their own or their lawyers' convenience. Nothing in the IOLTA rules, or any law, requires the clients to make this choice.

Second, in both *Webb's Fabulous Pharmacies* and *Sellers* the funds were of sufficient size, and deposited for a sufficient length of time, to earn net income above and beyond the cost of administering the deposits. In *Webb's Fabulous Pharmacies*, as this Court emphasized, the deposit earned \$90,000, none of which was needed to cover administrative costs because those costs had already been deducted from the principal. 449 U.S. at 158. Similarly, in *Sellers*, the single deposit at issue was earning \$6,000 each month it was held. 483 S.W.2d at 242. *Sellers* rejected the county's claim to all of that interest because the amount was "not reasonably related to the value of the county's services in safeguarding and investing the principal." 483 S.W.2d at 244.

The opposite is true of the interest at issue here. Because the IOLTA program is only lawfully available for client deposits that are not capable of earning interest in excess of administrative costs, the individual deposits in IOLTA accounts are not capable of earning *any* interest in excess of administrative costs for their owners.

Third, in both cases the only infirmity preventing the owners of the principal from investing the funds themselves was the delay imposed by the course of litigation. There is no indication in either decision that the owners could not themselves have placed the funds in identical accounts in their own names, if the funds were in their possession. The same is certainly not true for many clients whose deposits are placed in NOW accounts under

the IOLTA program. As discussed above, although most client deposits are needed quickly and therefore must be placed in demand accounts, demand accounts that pay interest are not available to corporations, most companies, partnerships, and many associations.

B. Contrary To The Fifth Circuit's View, Such Differences Are Critical To The Constitutional Analysis.

The existence or non-existence of a property interest turns on just such distinctions, as this Court has long recognized. This Court, for example, has found that the existence of a property owner's interest in the natural level of a stream turns on whether the stream is navigable. Thus, an interest in the natural flow-off of water in a non-navigable stream is a property interest protected by law, see *United States v. Cress*, 243 U.S. 316, 330 (1917), and an interest in the natural flow-off of water in a navigable stream is not, see *Willow River Power*, 324 U.S. at 511. Similarly, whether a teacher has a property interest in a renewed employment contract depends on the express terms of the existing contract, the employer's rules and policies, and the employer's practices. See *Perry v. Sinderman*, 408 U.S. 593, 601-02 (1971). A teacher's property interest in a renewed employment contract is therefore hinged on every change in an employer's rules, policies, or practices.

The Fifth Circuit's dismissal of such distinctions as too "fickle" a basis for determining the existence of a property right, Pet. App. 16a n.47 & 8a, is wholly at odds

with this Court's jurisprudence. This Court has consistently recognized that the existence of a property interest rests on just such particular and changeable factors. Property right claims require an inquiry into the laws, rules, express and implied contractual understandings that define the legitimacy of the claim, even though contracts and mutual understandings are often specific to the parties, and even though governing laws can be expected to change "from time to time, by various measures newly enacted by the State," especially with respect to personal property "by reason of the State's traditionally high degree of control over commercial dealings." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1027-28 (1992).

Indeed, the Fifth Circuit's extraction of a widely applicable general rule, "interest follows principal," from *Webb's Fabulous Pharmacies* and *Sellers*, Pet. App. 8a, 10a, is inconsistent even with those decisions. Neither purported to determine the existence of a constitutionally cognizable property right in interest under all circumstances. This Court emphasized the narrowness of its holding in *Webb's Fabulous Pharmacies*, limiting it to circumstances where deposit of the funds is required by state statute and where the administrative cost of handling the deposits has been paid separately. 449 U.S. at 164. Moreover, the Court expressly reserved judgment even with respect to interpleader interest under different circumstances, explaining:

We express no view as to the constitutionality of a statute that prescribes a county's retention of interest earned, where the interest would be the only return to the county for services it renders.

Id. at 165. Similarly, *Sellers'* finding of a property right was premised on the fact that more interest was generated than necessary to cover administrative costs. 483 S.W.2d at 243-44. The court therefore reinstated the trial court's judgment that the claimants had a right to the interest less a reasonable fee for administrative services. 483 S.W.2d at 244.¹⁶

The Fifth Circuit's reliance on these decisions to find a property interest attaching to accrued interest, regardless of whether it exceeds administrative costs, Pet. App. 13a, is unsupportable. *Webb's Fabulous Pharmacies* and *Sellers* applied the axiom "interest follows principal" not only where net interest existed but expressly *because* net interest existed. As other courts have noted:

when Justice Johnson observed in *Himely v. Rose* that 'interest goes with the principle, as the fruit with the tree,' his illustration necessarily assumed the existence of a fruit-bearing tree.

Cone, 819 F.2d at 1004 (quotations and citations omitted). Where, as here, the tree is incapable of bearing fruit for the owners of the deposits, those owners have no legitimate claim of entitlement to any fruit.¹⁷

¹⁶ See also *Harris County v. Sellers*, 468 S.W.2d 950, 954 (Tex. Civ. App. 1st Dist. 1971) (describing trial court's decision), *rev'd*, 483 S.W.2d 242 (Tex. 1972).

¹⁷ That these clients do not have the property interest asserted is underscored by considering how the Takings Clause would apply. The Takings Clause requires the government, when taking private property for public use, to pay "just compensation." U.S. Const. amend. V. Where, as here, the claimants have suffered neither actual losses nor lost

C. The Fact That An IOLTA Account Is Able To Earn Interest Does Not Confer A Property Right The Clients Otherwise Would Not Have.

The court below further misapplied *Webb's Fabulous Pharmacies* in concluding that, although Texas had no obligation to generate interest on client deposits, once the IOLTA program does, the interest belongs to the clients. This Court's recognition in *Webb's Fabulous Pharmacies* that the owners of an interpleaded deposit were entitled to net interest generated, even though the state was not obligated to place the deposit in an interest-bearing account, presupposed that the owners themselves could have made the same investment. In other words, the owners were entitled to the proceeds from the investment they could have made had they been permitted to take possession of the funds as early as they had a legitimate claim of entitlement to them.

The Fifth Circuit's decision at issue here, in contrast, is that the owners of funds who choose not to invest them are entitled to proceeds from an investment they are not entitled to make. That proposition finds no basis in *Webb's Fabulous Pharmacies* or in any other decision of this Court. Indeed, in *Dames & Moore*, this Court rejected an analogous argument. *Dames & Moore*, which had obtained an attachment on property of certain Iranian banks, challenged President Carter's revocation of licenses to obtain attachments of Iranian assets and nullification of all non-Iranian interests in such assets. 453

opportunity costs, "just compensation" would presumably be \$0, and the Takings Clause would not be implicated.

U.S. at 663. This Court rejected the company's argument that, although the President could have forbidden attachments, "once he allowed them the President permitted claimants to acquire property interests in their attachments." *Id.* at 674 n.6. This Court found that the only property right Dames & Moore acquired was limited by the President's ability to nullify it, and the fact that Dames & Moore had been permitted to obtain an attachment did not change Dames & Moore's position. *Id.*

Here, the existence of interest cannot change these clients' positions any more than the existence of an attachment changed Dames & Moore's position. These clients had no property right in interest on the funds if deposited in their own names – unlike the claimants in *Webb's Fabulous Pharmacies* – and continue to have no property right to interest on the funds. That some interest can be generated for a different entity altogether under prevailing laws and contractual understandings does not affect the legitimacy of these clients' claims to entitlement.

The Fifth Circuit's opposite rule cannot be correct, as is made even more clear by considering the dilemma of implementing it. Deposits from all types of clients are deposited in IOLTA accounts. Because the proceeds go to an IOLTA organization, deposits from many clients who are not themselves eligible for NOW accounts may be included. If, however, the interest belongs to these clients, the bank has violated federal law by opening the account in the first place and by paying the interest. Thus, the very interest that creates the clients' property interest, according to the Fifth Circuit, cannot lawfully exist under the court's reading.

Furthermore, wholly apart from that problem, the Fifth Circuit's conclusion that these clients have a property right to the interest triggers a series of practical and legal obligations. Both interest and charges must be apportioned among those clients whose deposits have been placed in the account and various tax reporting rules must be complied with. However, the bank charges, or lawyer's fee, for providing these subaccounting services, given the nominal amount or short duration of the deposits, can be expected to be larger than the interest generated by the account.¹⁸ As a result, in most if not all cases, the accrued interest and probably some of the principal will be required to cover the charges.

Application of the Fifth Circuit's finding of a property right to the interest on IOLTA accounts, if IOLTA rules are deemed a taking, will almost certainly provide no interest to these clients, and will likely cost them part of their principal – an amount that is fully protected and

¹⁸ As explained *supra*, the reason client deposits placed in IOLTA accounts earn sufficient interest to offset costs is because all of the interest and charges are aggregated and designated for the non-profit IOLTA entity. If, instead, the interest and charges have to be apportioned among the clients with funds held in the IOLTA account, the charges will most likely equal or exceed the amount of interest accruing to each client. This effect is illustrated by the claim at issue in *Cone*, 819 F.2d 1002. The client's nominal deposit of \$13.75 would have earned \$.06 per month in gross interest. The bank charged \$2.00 per month for each subaccount in a pooled account, plus \$.25 per transaction. *Id.* at 1006 n.6. Recognition of such a client's property right to the interest in an IOLTA account would have cost the client \$1.94 of principal each month, assuming no transactions and no additional bank charges.

available on demand under the IOLTA rules. The actual value of the property interest recognized by the Fifth Circuit, even if it could exist lawfully, which it cannot, basically ranges between zero and a net loss.

In sum, under prevailing law and contractual understandings, *this* property right and *this* interest cannot coexist. The generation of income from these accounts is *contingent* on the clients having no interest in it. If they do, the disputed property ceases to exist.

It is a conundrum easily avoided by recognizing that the question of what property interest, if any, these clients have must be answered by reference to the client's legitimate claims of entitlement to the interest, and not by reference to the legitimate claims of any other persons or entities. Thus, the banks' ability to use client deposits to earn income before the banking laws were changed and IOLTA programs were instituted did not, and cannot, confer a property interest on the clients in that income. Likewise, an IOLTA organization's ability to use client deposits to earn income also cannot confer a property interest on the clients in that income. The only claims to income on their deposits that these clients may legitimately assert must be grounded in the prevailing law and contractual understandings, apart from IOLTA rules, that affect them.

For most clients, the change in the banking laws in 1980 had no effect on their right to income from deposits. And, under IOLTA rules, these are the only clients whose deposits may be placed in IOLTA accounts. Thus, the clients whose deposits are placed in IOLTA accounts stand in the same position as before. The existence of

interest under the IOLTA system, like the existence of income from the deposits under the traditional system, does not affect the calculus for assessing their claims of entitlement.

CONCLUSION

For the foregoing reasons, this Court should reverse the decision of the court of appeals below.

Respectfully submitted,

JEROME J. SHESTACK*

President

American Bar Association

750 N. Lakeshore Drive

Chicago, Illinois 60611

(312) 988-5000

JEROLD S. SOLOVY

BARRY LEVENSTAM

PAUL M. SMITH

NORY MILLER

JEFFREY I. RYEN

JENNER & BLOCK

601 Thirteenth Street, N.W.

Washington, D.C. 20005

(202) 639-6000

Attorneys for Amicus Curiae

August 25, 1997

* *Counsel of Record*

APPENDIX

Listed below is the citation of the authorizing legislation or court rule for each of the 50 operational IOLTA programs in the United States.

Alabama:	Alabama Rules of Professional Conduct, Rule 1.15 (1992)
Alaska:	Alaska Rules of Professional Conduct, Rule 1.15(d) (1989)
Arizona:	Code of Professional Responsibility, DR 9-102; Rules of the Arizona Supreme Court, Rule 29(a) (1984)
Arkansas:	Arkansas Model Rules of Professional Conduct, Rule 1.15 (1994)
California:	CAL. BUS. & PROF. CODE § 6210-6228 of Article 14, Chapter 4 (1981)
Colorado:	Colorado Rules of Professional Conduct, Rule 1.15 (1992)
Connecticut:	CONN. GEN. STAT. § 51-81(c) (1993); Connecticut Rules of Professional Conduct, Rule 1.15 (1993)
Delaware:	Delaware Lawyers' Code of Professional Responsibility, DR 9-102 (1983)
D.C.:	District of Columbia Court of Appeals Rules Governing the Bar, Rule 10, Appendix B (1985)
Florida:	Rules Regulating the Florida Bar, Rule 5-1.1(d) (1989)
Georgia:	Rules and Regulations for the Organization and Government of the State Bar of

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	Georgia, Rule 4-102(d), Standard 65; Georgia Code of Professional Responsibility, DR 9-102(c), Rule 3-109 (1989)
Hawaii:	Rules of the Hawaii Supreme Court, Rule 11 (1991)
Idaho:	Idaho Rules of Professional Conduct, Rule 1.15 (1989)
Illinois:	Illinois Rules of Professional Conduct of the Rules of the Supreme Court of Illinois, Article 8, Rule 1.15 (1987)
Iowa:	Iowa Code of Professional Responsibility, DR 9-103 (1985)
Kansas:	Kansas Model Rules of Professional Conduct, Rule 1.15 (1992)
Kentucky:	Kentucky Supreme Court Rule 3.830 (1991)
Louisiana:	Louisiana Rules of Professional Conduct, Rule 1.15 (1995)
Maine:	Maine Bar Rules, Rules 3.6(e)(4), (5) (1993)
Maryland:	MD. CODE ANN. BUS. OCC. & PROF., § 10-303 (1995)
MA.:	Massachusetts Supreme Judicial Court Rule 3:07; Code of Professional Responsibility, DR 9-102 (1990)
Michigan:	Michigan Rules of Professional Conduct, Rule 1.15 (1990)
Minnesota:	Minnesota Rules of Professional Conduct, Rule 1.15(d) (1993)
Mississippi:	Mississippi Rules of Professional Conduct, Rule 1.15 (1993)
Montana:	Montana Rules of Professional Conduct, Rule 1.15 and Rule 1.18 (1996)

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Nebraska:	Nebraska Code of Professional Responsibility, DR 9-102 (1984)
Nevada:	NEV. REV. STAT. §§ 217-221 (1992)
New Hampshire:	New Hampshire Supreme Court Rules 50 and 50-A (1991)
New Jersey:	New Jersey Supreme Court Rule 1:28A (1988)
New Mexico:	New Mexico Rules of Professional Conduct, Rule 16-115 (1988)
New York:	N.Y. JUD. LAW § 497 (McKinney 1988); N.Y. STATE FIN. § 97-v (McKinney 1984)
North Carolina:	North Carolina Rules of Professional Conduct, Rule 10.3 (1988)
North Dakota:	North Dakota Rules of Professional Conduct, Rule 1.15 (1987)
Ohio:	OHIO REV. CODE ANN. § 4705.09 and § 4705.10 (1985)
Oklahoma:	Oklahoma Rules of Professional Conduct, Rule 1.15 (1983)
Oregon:	Oregon Code of Professional Responsibility, DR 9-101(D) (1989)
Pennsylvania:	Pennsylvania Rules of Professional Conduct, Rule 1.15 (1996)
Rhode Island:	Rhode Island Rules of Professional Conduct, Rule 1.15 (1988)
South Carolina:	South Carolina Appellate Court Rules, Rule 412 (1987)
South Dakota:	South Dakota Rules of Professional Conduct, Rule 1.15 (1987)

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Tennessee:	Tennessee Code of Professional Responsibility, DR 9-102 (1984)
Texas:	State Bar of Texas Rules, Article XI (1982)
Utah:	Utah Rules of Professional Conduct, Rule 1.15 (1983)
Vermont:	Vermont Code of Professional Responsibility, DR 9-103 (1990)
Virginia:	Rules of the Virginia Supreme Court, Canon 9, Paragraph 20 of Part 6, § IV (1995)
Washington:	Washington Rules of Professional Conduct, Rule 1.14 (1984)
West Virginia:	West Virginia Rules of Professional Conduct, Rule 1.15 (1989)
Wisconsin:	Wisconsin Supreme Court Rules, Rule 20:1.15 (1989)
Wyoming:	Wyoming Rules of Professional Conduct for Attorneys at Law, Rule 1.15 (1990)

AUG 25 1997

CLERK

In the

Supreme Court of the United States

OCTOBER TERM, 1997

HON. THOMAS R. PHILLIPS, HON. RAUL A.
GONZALEZ, HON. JACK HIGHTOWER, HON. NATHAN
L. HECHT, HON. LLOYD DOGGETT, HON. JOHN
CORNYN, HON. BOB GAMMAGE, HON. CRAIG T
ENOCH, HON. ROSE SPECTOR, TEXAS EQUAL ACCESS
TO JUSTICE FOUNDATION, AND W. FRANK NEWTON,
IN HIS OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS
EQUAL ACCESS TO JUSTICE FOUNDATION,

Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT.

**AMICUS BRIEF OF MASSACHUSETTS BAR FOUNDATION
IN SUPPORT OF PETITIONERS.**

HENRY C. DINGER, P.C.
GOODWIN, PROCTER & HOAR LLP
Exchange Place
Boston, Massachusetts 02109
(617) 570-1000

*Counsel for the Massachusetts Bar
Foundation, amicus curiae*

27 p/p

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No. 96-1578

In the

Supreme Court of the United States

OCTOBER TERM, 1997

HON. THOMAS R. PHILLIPS, HON. RAUL A.
GONZALEZ, HON. JACK HIGHTOWER, HON. NATHAN
L. HECHT, HON. LLOYD DOGGETT, HON. JOHN
CORNYN, HON. BOB GAMMAGE, HON. CRAIG T.
ENOCH, HON. ROSE SPECTOR, TEXAS EQUAL ACCESS
TO JUSTICE FOUNDATION, AND W. FRANK NEWTON,
IN HIS OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS
EQUAL ACCESS TO JUSTICE FOUNDATION,
Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
SUMMERS, AND MICHAEL J. MAZZONE,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT.

**AMICUS BRIEF OF MASSACHUSETTS BAR
FOUNDATION IN SUPPORT OF PETITIONERS.**

The Massachusetts Bar Foundation ("MBF") hereby sub-
mits this brief as amicus curiae in support of the petitioners in

this matter. Petitioners and respondents have consented to MBF's participation as amicus. Letters setting forth this consent accompany this brief.

Interest of Amicus Curiae

The MBF is a charitable corporation established in 1964 as the charitable arm of the Massachusetts Bar Association, the principal statewide organization of lawyers practicing in the Commonwealth of Massachusetts.

In 1985, the Massachusetts Supreme Judicial Court established the Interest on Lawyers' Trust Accounts ("IOLTA") program in Massachusetts that permitted lawyers to pool short-term and nominal client funds entrusted to their custody in interest-bearing accounts with the interest payable to certain organizations, including MBF, that fund legal services for indigents and programs for improving the administration of justice. *See generally* *Petition of Massachusetts Bar Association*, 395 Mass. 1, 478 N.E.2d 715 (1985). The Court later required all Massachusetts lawyers to use IOLTA accounts for such client funds.

MBF currently is responsible for allocating approximately one-quarter of the funds raised by the Massachusetts IOLTA program, nearly \$2 million in 1996. In Massachusetts, IOLTA funds not only traditional legal services programs for the benefit of people unable to afford representation (in divorce cases, landlord-tenant disputes, and the like) but also programs designed to enhance the administration of justice. Recent grant recipients have included several mediation and other alternative dispute resolution programs that have the effect of reducing congestion in Massachusetts courts, as well as programs providing coordination and support for "lawyer for a day" and other pro bono projects that assist pro se litigants and other

unrepresented persons. The Flaschner Judicial Institute, an organization dedicated to providing continuing education programs for judges in Massachusetts, receives a significant portion of its funding from the Massachusetts IOLTA program.

In 1991, respondent, Washington Legal Foundation, and several individuals brought suit in the United States District Court for the District of Massachusetts against the Massachusetts Supreme Judicial Court, the MBF and other parties involved in the Massachusetts IOLTA program challenging the constitutionality of that program on grounds essentially identical to those raised here. The First Circuit affirmed the dismissal of those claims, finding that the IOLTA program neither took the property of Massachusetts lawyers or their clients in violation of the Fifth Amendment, nor infringed their rights under the First Amendment. *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962 (1st Cir. 1993).

MBF has a direct interest in this case because the Texas IOLTA program in many respects is similar to the Massachusetts program and a decision by this Court upholding the Fifth Circuit's conclusion that the former is unconstitutional may pose a direct threat to the Massachusetts program. If the Massachusetts IOLTA program is invalidated in its current compulsory form, the resources available to advance the common goals of MBF and the IOLTA program will be dramatically reduced.

MBF shares with this Court a passionate commitment to "equal justice under law," as well as a deep concern for improving the administration of justice in state and federal court systems. In this age of diminished public funding of legal services and the judiciary, the IOLTA program is an essential part of achieving these goals.

Summary of Argument

The Fifth Circuit erred for two reasons when it found that the Texas IOLTA program effectuated an uncompensated taking of property in violation of the Taking Clause. First, the right to direct the allocation of interest earned on nominal or short-term client funds deposited by lawyers in IOLTA accounts is not a "property" right. Historically, the decision by clients to entrust such funds to lawyers has never been an investment decision undertaken with any expectation of earning an economic return. The transaction costs associated with allocating to particular clients the small amount of interest that such funds could generate would exceed the value of that interest. As a result, there has never been a legitimate, historically validated expectation either to receive any return from the deposit of nominal or short-term client funds or to have any control over the disposition of the bank's return on the investment of such deposits. Accordingly, the IOLTA program's requirement that lawyers place such funds in accounts with respect to which the depository bank agrees to pay interest to TEAJF takes no client "property."

Second, even if the Texas IOLTA program did affect "property" interests, the extent of any interference is so minimal that no "taking" can be found. It is undisputed that the clients whose funds are deposited in IOLTA accounts suffer no economic harm whatever. The value of their "property" is exactly as it would be in the absence of the IOLTA program. Because the economic impact of the program to clients is insignificant and alters no reasonable investment-backed expectations, and because the public interest served by the IOLTA program is a legitimate and important one, there is no regulatory taking.

Nor does the IOLTA program constitute a *per se* taking without regard to the usual balancing test applicable to regu-

latory takings. The program effectuates no physical invasion of property. Nor does it deprive clients of all beneficial use of their property. In this regard, *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), is distinguishable. There, the parties with a property interest in the interpleaded funds were involuntarily deprived of *all* beneficial use of the funds for a significant period of time because the funds were completely unavailable to those parties and 100% of the interest — a sizable sum in *Webb's* — was retained by the State. By contrast, clients whose funds are deposited in Texas IOLTA accounts entrust such funds voluntarily to their lawyers, have access to the principal on demand and lose no interest that they otherwise would have obtained. The IOLTA program is in no way confiscatory and therefore does not constitute a *per se* taking.

Argument

I. THE TEXAS IOLTA PROGRAM DOES NOT CONSTITUTE AN UNCONSTITUTIONAL TAKING OF THE PROPERTY OF CLIENTS IN TEXAS.

A. The right to allocate interest on nominal and short-term funds entrusted to Texas lawyers is not a property right of clients.

1. Historically, clients had no expectation of obtaining any investment return on nominal and short-term funds entrusted to their lawyers.

There is no dispute that funds entrusted to Texas lawyers by their clients are the "property" of the clients. Nor is there any dispute that the ethical rules governing the conduct of lawyers in Texas require lawyers to deposit those funds so that they are available to clients on demand. Nor is there any dispute that client funds eligible for deposit in IOLTA accounts are so small in amount or will be held for such a short period of time that the modest interest that a bank would pay on such funds would be less than the expense associated with accounting for those funds, reporting them to clients for tax purposes, and making the funds actually available to the clients. That is why nominal or short-term client funds historically have been held in non-interest bearing accounts.

That historical fact is important here. Because there has historically been no practical way to earn a return on nominal or short-term client funds, clients have never had any expectation of earning a return on such funds. The decision to entrust such funds to a lawyer has never been an investment decision; it has always been, rather, a decision born of convenience and the need for security. Alternative arrangements — e.g., es-

crow accounts, more formal trust arrangements — would impose costs and delays that clients are happy to avoid.

The changes in federal banking law that permitted banks in effect to pay interest on demand accounts did not change these economic realities. Those changes did not reduce the administrative costs of processing interest on client's nominal or short-term funds. Client funds that could not be invested to generate a positive return to the client before the advent of NOW (i.e. "negotiable order of withdrawal") accounts, could not be so invested afterwards.

What the advent of NOW accounts did create was the possibility of generating an economic return on pooled client demand accounts. The generation of interest is possible only if the administrative costs that would be required to allocate the interest on such accounts among the clients whose funds are pooled can be avoided. This is not a matter of "alchemy," but rather the predictable effect of economies of scale. The aggregation of many small or short term deposits in a single account allows the payment of interest in amounts that exceed the administrative costs associated with the account *viewed as the account of a single depositor*. This is true even though the costs that would be associated with allocating the interest among the clients would still exceed the interest on the account as a whole.¹

Despite these characteristics, the Fifth Circuit concluded that the interest paid by the banks holding IOLTA accounts to TEAJF is the "property" of the clients whose pooled short-

¹ This problem cannot be avoided by the bank's reporting the aggregate interest on the pooled client account to the lawyer. The lawyer's office would then have the task of calculating the amount of the interest allocable to each client, processing the payment of those portions to each client, and satisfying the reporting obligations associated with the tax laws. The lawyer would be entitled to charge the client for the expenses incurred in performing these tasks, charges that would more than wipe out the interest to be paid.

term and nominal funds generated the interest. The Fifth Circuit erred in reaching this conclusion. When measured against the criteria that this Court has employed to identify "property" interests, it is clear that no property interest is involved in this case.

2. Property rights do not arise from the Constitution, but rather from expectations that have historically received general legal protection.

This Court has recognized consistently that the protections for "property" rights in the Fifth and Fourteenth Amendments do not themselves create such rights. "Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law." *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). Moreover, as this Court noted in *Roth*:

To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it. It is a purpose of the ancient institution of property to protect those claims upon which people rely in their daily lives, reliance that must not be arbitrarily undermined.

Id. See also *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1027-31 (1992); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 1000-04 (1984).

In other words, it is the consistent recognition of a particular right over time, giving rise to a reasonable, widely shared (as opposed to a merely "unilateral") expectation that the right

will continue to be recognized, that permits the characterization of a right as "property." See *Lucas*, 505 U.S. at 1016 n.7, 1027. It is only by stressing historical recognitions giving rise to reasonable expectations that one can avoid the circularity of the simplistic notion that property is whatever the State says it is. Otherwise, the State could, "by *ipse dixit*, . . . transform private property into public property without compensation," contrary to the plain import of the Takings Clause. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980).

3. The interests of clients in controlling the interest paid on IOLTA accounts does not constitute a "property" interest.

The Fifth Circuit based its ruling that the interest generated on IOLTA accounts constitutes the "property" of the clients whose nominal and short-term funds are held in those accounts on the maxim that "interest follows principal," *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, 94 F.3d 996, 1000 (5th Cir. 1996), a maxim that the court found to be the "traditional rule" under Texas law, *id.*, as well as the predicate for this Court's ruling in *Webb's*, *id.* at 1001. In so ruling, the court allowed the maxim to substitute for the kind of analysis that this Court has applied in identifying "property" interests. If one undertakes the necessary analysis, the error of the Fifth Circuit becomes apparent.

The maxim "interest follows principal" reflects the general understanding that when property is invested, any positive return on the investment ordinarily belongs to the owner of the invested property. For example, minerals and crops ordinarily belong to the owner of the land on which the mine or field is found.

This is not always the case, of course. Income can be severed from the property that generates it. For example, Texas law recognizes the power of trust settlors to create disjoint sets of income and principal beneficiaries. See Texas Property Code Ann. § 113.103 (West 1995); *Wilkes v. Wilkes*, 488 S.W.2d 398 (Tex. 1972); *Van Hoose v. Moore*, 441 S.W.2d 597 (Tex. Civ. App. 1969). Disparities between ownership of principal and interest can occur by operation of law as well. Although spouses retain sole title of property they owned before marriage, income generated by such property during the marriage is community property under Texas law. See Tex. Fam. Code Ann. § 5.01 (West 1995); *Broday v. United States*, 455 F.2d 1097 (5th Cir. 1972); *C.I.R. v. Chase Manhattan Bank*, 259 F.2d 231, 239 (5th Cir. 1958), *cert. denied*, 359 U.S. 913 (1959). Nevertheless, in most situations involving investment property, absent a voluntary modification by the property's owner, ownership of the principal entitles one to own the investment return.

Not every use of property, however, is an investment undertaken in anticipation of an economic return. Before the advent of NOW accounts, most people maintained checking accounts at banks that paid no interest on the funds deposited. As a matter of law in Texas (and generally elsewhere) the relationship between a bank and a depositor is that of debtor-creditor, founded on contract. *Bank of Marin v. England*, 385 U.S. 99, 101 (1966); *Great Com. Life Ins. Co. v. Banco Ob- rero de Ahorro*, 535 F.2d 331, 331 (5th Cir. 1976); *American Bank of Waco v. Waco Airmotive, Inc.*, 818 S.W.2d 163, 170 (Tex. Ct. App. 1991). Under this contractual relationship, the bank becomes absolute owner of the money as soon as it is received. See *Texas Commerce Bank v. Townsend*, 786 S.W.2d 53, 54 (Tex. Ct. App. 1990); *Stone Fort Nat. Bank of Nacogdoches*, 91 S.W.2d 674, 676 (Tex. 1936). The bank's obligation to a checking account depositor is to repay the

amount due to the depositor upon demand and to honor checks properly drawn on the account. The bank is free to commingle the funds from its depositors and invest it as it pleases. *New York County Nat. Bank v. Massey*, 192 U.S. 138, 145 (1904), *cf. Texas Commerce Bank*, 786 S.W.2d at 54.

To be sure, deposited funds are invested by the depository bank (in mortgages, commercial loans, and the like) to earn a return that exceeds the expenses of the bank allocable to the deposit. The depositor has no property interest in that return, however. Whatever the bank earns on its investment of deposits is the bank's property, not the depositor's. Nor does the depositor have any right to affect the bank's own investment decisions. An atheist has no property right to veto a bank's decision to lend money for the construction of a church, or to make contributions to religious charities. The only legitimate expectation of the depositor is that the bank will honor its contractual obligation to make the funds available on demand and to honor checks drawn on the account for which sufficient funds are available.

As noted above, nominal and short-term client funds entrusted to lawyers historically were deposited in pooled non-interest bearing accounts maintained in the name of the lawyer. Such accounts earned no interest for the owner of the deposit; there was no expectation of obtaining an investment return on such funds because the decision to entrust was not an investment decision. The funds were such that there could be no reasonable expectation of a return.

The Texas IOLTA program did not alter the expectations of clients in this regard at all. Nominal and short-term client funds in IOLTA accounts remain secure and available on demand. The only difference is that instead of keeping all of the money that it earns from the investment of deposits in client trust accounts, the bank agrees (if it wants to keep such deposits) to pay that portion of its earnings on those deposits to

TEAJF. Clients, however, never had any expectation of affecting the bank's return on its investment of deposited funds. None of the strands in the bundle of rights constituting the property interest of clients in nominal or short-term funds entrusted to their lawyers is diminished or removed.

Invoking the "right to exclude others" does not warrant a different conclusion. To be sure, in other, quite different contexts the "right to exclude" constitutes the dominant strand in the bundle of rights we call "property." See, e.g., *Ruckelshaus*, 467 U. S. at 1011-12; *Kaiser Aetna v. United States*, 444 U.S. 164, 176, 179-80 (1979). But clients have never had the right to exclude others from the benefit of the economic return on their deposits while held in client fund accounts. That has always been a matter for the bank alone to determine, subject to federal and state banking regulations. By directing lawyers to deposit such funds in banks that agree to pay a portion of their return to TEAJF, Texas has not affected any "right to exclude," since clients have never had such a right in their property "bundle" to begin with.

B. *Even if clients have a technical property interest in the interest accrued on funds deposited in IOLTA accounts, Texas IOLTA program does not cause a compensable taking.*

1. This Court's decision in *Webb's Fabulous Pharmacies* does not establish a rule that the IOLTA program's requirements concerning interest on IOLTA accounts constitutes a *per se* taking under the Fifth Amendment.

Critical to the Fifth Circuit's decision in this case is its reading of *Webb's Fabulous Pharmacies* as having "create[d]

a rule that is independent of the amount or value of interest at issue, holding that a property interest existed in the accrued interest simply because "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." 94 F.3d at 1002 (quoting *Webb's*, 449 U.S. at 164). The Fifth Circuit's interpretation of *Webb's* is incorrect. Properly understood in light of this Court's later development of taking law, *Webb's* is entirely consistent with the district court's conclusion that the Texas IOLTA program causes no unconstitutional taking.

Webb's arose out of an agreement to purchase substantially all of the assets of a Florida corporation for approximately \$2 million. Since the seller owed substantial sums, the buyer feared that the conveyance would be challenged by the seller's creditors as fraudulent. Florida law permitted the buyer to obtain clear title by depositing the purchase price into court and interpleading the seller and its creditors, and the buyer did so. *Webb's*, 449 U.S. at 156 & n.2.

This Court recognized that under the law of Florida and elsewhere, the funds deposited were "private property." *Id.* at 160-61. The sole purpose of the interpleader action was to resolve the competing claims of the seller and its creditors to the funds deposited. Florida statutory law directed the clerk of court to invest the funds in "designated depository banks in interest-bearing certificates" and provided not only that the clerk charge a fee for the administrative services associated with accepting the deposit, but also that the interest generated "shall be deemed income of the office of the clerk of the circuit court investing such moneys." *Id.* at 156 n.1, 157 n.3. Pursuant to this statute, when the funds were transferred to a receiver for the seller, the clerk retained the accumulated interest which exceeded \$100,000. The creditors claimed that the retention of the interest constituted an unconstitutional taking. This Court agreed.

Justice Blackmun's opinion for the Court does not explain in great detail the rationale for the Court's conclusion. The Court stated that the "usual and general rule is that any interest on an interpleaded and deposited fund follows the principal and is to be allocated to those who are ultimately to be the owners of that principal." *Id.* at 162. Justice Blackmun then noted that while the government "may deny the property owner of some beneficial use of his property . . . , if such public action is justified as promoting the general welfare," *id.* at 163, in the case before the Court, "[n]o police power justification is offered for the deprivation," *id.*² The Court ruled that the withholding of interest was an uncompensated taking of property.

Since *Webb's* was decided, this Court has developed its takings jurisprudence in a series of cases that have recognized two distinct branches of takings analysis.

Where government regulation merely reduces the value of property, the Court has applied an "essentially ad hoc, factual inquiry," *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992) (quoting *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978)), intended to ascertain whether the regulation has gone "too far," *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922). The Court has identified three factors that have "particular significance:" "(1) 'the economic impact of the regulation on the claimant'; (2) 'the extent to which the regulation has interfered with distinct investment-backed expectations'; and (3) 'the character of the

² Significantly, the state could not justify the withholding of interest as a means for compensating the state for the expenses associated with the administration of the fund pending the resolution of the interpleader proceeding. Florida law authorized the retention of a fee, calculated as a function of the amount deposited, in addition to the withholding of the interest. There was no challenge to the fee. This Court's later decision in *United States v. Sperry Corp.*, 493 U.S. 52, 62 (1989), makes it clear that no such challenge would have succeeded.

governmental action." *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225 (1986) (quoting *Penn Central*, 438 U.S. at 124).

The Court has identified two types of governmental action that constitute categorical or *per se* takings "without case-specific inquiry into the public interest advanced in support of the restraint." *Lucas*, 505 U.S. at 1015. The first type of categorical taking involves government action that brings about a "physical invasion" of real property. *See, e.g., Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) (permanent fixing of cable facilities); *United States v. Causby*, 328 U.S. 256 (1946) (physical invasion of airspace). *Cf. Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987) (grant of building permit contingent on dedication of public easement).

The Texas IOLTA program plainly does not effect a physical taking of any property owned by Texas clients. Subsequent to *Webb's*, this Court made it clear that the withholding of payment from funds held by the government does not constitute a physical taking. *United States v. Sperry Corp.*, 493 U.S. 52, 59-64 (1989). *See also Yee v. City of Escondido*, 503 U.S. 519, 526-32 (1992); *Concrete Pipe & Products of California, Inc. v. Construction Laborers Pension Trust*, 508 U.S. 602, 643-44 (1993). Where, as here, the government action does not deprive the property owner of anything that the owner would have had in the absence of the government action, there is nothing that can be characterized as a physical taking.

The second category of *per se* taking arises in situations "where regulation denies all economically beneficial or productive use" of property, *Lucas*, 505 U.S. at 1015. *See, e.g., id.* (denial of permit to build habitable structures). *Cf. Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1010-14 (1984) (regulation destroying the economic value of trade secrets

constitutes a taking). Where such a *per se* taking has occurred, the taking authority generally must pay compensation regardless of the magnitude of the harm.

The Fifth Circuit appears to have read *Webb's* as recognizing a distinct property right in the interest earned on funds deposited with a court and forbidding a state from taking that entire property interest. See 93 F.3d at 1002. In this respect, the Fifth Circuit misread *Webb's*.

The *Webb's* Court did not view the interest on the deposited funds as a property interest separate from the funds themselves, but rather as an incident of the ownership of the principal, "the fruit of the fund's use," as the Court put it. 449 U.S. at 162. The right to interest is thus merely one of the "sticks in the bundle of rights that are commonly characterized as property." *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979). Although it is at times difficult to draw the line between a "confiscatory" taking of an entire property interest and a diminishing of the value of property by removing a "stick" from the "bundle," see *Lucas*, 505 U.S. at 1016 n.7, this Court in *Webb's* recognized that generally "interest . . . follows . . . principal," 449 U.S. at 162.³

³ Application of the "ad hoc" analysis based on the three factors identified in *Penn Central* to the facts of *Webb's* clearly establishes that the retention of interest (in addition to a fee for services) in interpleader cases would constitute an impermissible regulatory taking. The "economic impact of the regulation on the claimant" was obviously substantial. The state kept more than \$100,000 above and beyond its fee for administrative services. The retention of interest also had a significant effect on "distinct investment-backed expectations." The seller had such an expectation in getting paid for the assets it sold, and its creditors had a similar interest in getting paid for the goods and services they had sold to the seller. But for the commencement of the interpleader action and the consequent delay in the distribution of the asset sale proceeds, they presumably would have received payment promptly following the sale of *Webb's* assets and would have been able to put the payment to productive use. As to the "character of the government's action," this Court stressed in *Webb's* that "[n]o police power justification is offered for the deprivation" of the interest. *Id.* at 163. See *Sperry Corp.*, 493 U.S. at 62 n.8. Un-

The focus of this Court in *Webb's* was not simply on the interest earned on the deposit, but rather on the temporary loss of the *entire* beneficial use of the property — principal *and* interest. The Court observed that "[t]he county's appropriation of the beneficial use of the fund is analogous to the appropriation of the use of private property in *United States v. Causby*." 449 U.S. at 163-64. In *Causby*, flights in and out of an airport leased by the federal government during the Second World War flew so low over the plaintiffs' chicken farm that they became unable to use the property. The destruction of what the Court called the "owner's right to possess and exploit the land — that is to say, his beneficial ownership of it," 328 U.S. at 262, entitled the owner to compensation for a taking.

The Court in *Causby* noted that the owners would be entitled to compensation whether the servitude imposed by the passage of low-flying government aircraft over their farm was permanent or temporary, although the anticipated duration of the servitude would affect the amount of compensation. *Id.* at 267-68. In other cases, this Court has repeated that temporary takings of property are entitled to compensation for the lost beneficial use of their property during the period of the loss. See, e.g., *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 318-19 (1987).

The point of the analogy between *Causby* and *Webb's* is that in both cases the property owners lost *all* beneficial use of their property, at least temporarily. In *Causby*, farmers lost their ability to use their farm as a farm at all, at least during the government's heavy use of the airfield during wartime 328 U.S. at 259. In *Webb's*, the seller and creditors lost not only the interest on their funds, but also their ability to use their money at all during the period in which the fund was depos-

der the Court's current regulatory taking standards, it is quite certain that the result in *Webb's* would be the same.

ited with the county court. It was the *total* loss of beneficial use that gave rise to the compensable taking.

If, as the foregoing analysis suggests, the focus in *Webb's* was the temporary *total* loss of beneficial use of the funds for a period of time, then *Webb's* has far less application to the Texas IOLTA program than the Fifth Circuit believed. There is no sense in which the IOLTA program deprives unwilling clients of the entire beneficial use of their funds as a comparison of the situation in *Webb's* and that of Texas clients makes clear:

(i) The property owners in *Webb's* had no choice as to the loss of any access to or use of their property. By creating the interpleader remedy, the state permitted a third party to invoke the power of the state to deprive the property owners of such access and use without their consent pending the resolution of particular disputes. Clients in Texas need not authorize their lawyers to hold their funds at all.⁴

(ii) The property owners in *Webb's* had no access to their funds during the pendency of the interpleader action. Client funds in lawyer trust accounts, including IOLTA accounts, must be available to clients on demand.

⁴ See *Yee*, 503 U.S. at 527-28 (owner of mobile home park subjected to rent control statute had power to terminate leases and use property for other purposes; no taking found despite diminution of economic value); *Ruckelshaus*, 467 U.S. at 1005-08 (no taking of trade secrets where secrets disclosed to government agency as part of license application under regulatory scheme explicitly contemplating disclosure under specified circumstances; since property owner knew in advance the information might be disclosed, could avoid the disclosure by not seeking a license, and received compensating government benefits the owner waived any objection to the taking); *Nollan*, 483 U.S. at 833 n.2 (explaining *Ruckelshaus*).

(iii) The property owners in *Webb's* had a reasonable, investment-backed expectation of being able to use and obtain a return on their portion of the sales proceeds from the time the buyer paid funds into court, an expectation that the commencement of the interpleader action thwarted. The only funds that can be deposited in Texas IOLTA accounts are funds as to which clients have no expectation of obtaining any kind of economic return. In other words, the beneficial use of funds deposited in Texas IOLTA accounts does not include any expectation of interest or other investment return while the lawyer holds the funds.

In short, while the property owners in *Webb's* were deprived of all beneficial use of their funds during the pendency of the interpleader action, clients who choose to entrust funds to their lawyers lose no beneficial use of their funds as a result of the Texas IOLTA program that they would not have lost in the absence of that program. If any "stick" in the property "bundle" was taken, it was no more than a "twig." As a result, that program does not involve a *per se* taking.

2. The Texas IOLTA program does not effectuate a regulatory taking because it has no adverse economic impact on the pertinent property owners.

As noted above, whether regulatory activity causes a taking depends on a particularized factual inquiry into the character of the governmental action, the economic impact of the regulation on the affected property owner, and the extent to which the regulation has interfered with the owner's distinct invest-

ment-backed expectations. Consideration of these factors in the context of the Texas IOLTA program compels the conclusion that even if there is some metaphysical "property" interest on the part of clients in the interest generated by funds deposited in IOLTA accounts, the IOLTA program does not bring about a taking requiring compensation under the Fifth Amendment.

i. *The character of the government action.* The character of the Texas IOLTA program is not in dispute. It is a program the sole purpose of which is to provide funding for non-profit organizations that deliver legal services to persons unable to afford those services or advance the administration of justice. This is unquestionably a legitimate and proper government goal. It presents a stark contrast with *Webb's* where the State advanced "[n]o police power justification" for withholding the interest on funds in interpleader action. 449 U.S. at 163.

ii. *The economic impact of the IOLTA program on clients.* The economic impact of the IOLTA program on clients is non-existent by design. Client funds that are large enough or held long enough to generate any positive economic return to the clients are ineligible for IOLTA. Recognizing this, respondents have argued that they have lost the right to exclude others from any beneficial use of their deposits. While this Court has recognized (in very different contexts) the deprivation of a right of exclusion as having potential significance in a takings analysis,⁵ where that right does not in fact have an economic significance, its loss through regulation will not give rise to a taking.

For example, in *PruneYard Shopping Center v. Robins*, 447 U.S. 74 (1980), State law compelled a private shopping center owner to permit members of the public to distribute pamphlets

⁵ See, e.g., *Nollan*, 483 U.S. at 831; *Loretto*, 458 U.S. at 433; *Kaiser Aetna*, 444 U.S. at 176.

and solicit petition signatures in the center, thus depriving the owner of the right of a private property owner to exclude. Yet the Court rejected the owner's taking claim, finding that "[t]here is nothing to suggest that preventing appellants from prohibiting this sort of activity will unreasonably impair the value or use of their property as a shopping center." *Id.* at 83. The same analysis applies here as well.

iii. *The effect on reasonable investment-backed expectations.* The IOLTA program has no impact whatever on reasonable investment-backed expectations. Clients who entrust to their lawyers either very small sums of money or funds that will be held for very brief periods of time, have never had any expectation of receiving any investment return. The decision to entrust is not an investment decision, but rather a decision born of convenience and the need for security. It is simply easier in many instances to permit the lawyer to hold the funds than to set up separate trust or escrow arrangements. While the funds deposited in client funds accounts have always generated a return for the depository bank, the clients have never had any say in the bank's disposition of those funds.

The Texas IOLTA program deprives no client of anything the client expected to receive before the program was established.

* * * *

Analyzed under the principles applicable to regulatory takings, the IOLTA program manifestly does not constitute a taking. As this Court stated in *Webb's*, "governmental action that may deny the property owner of some beneficial use of his property" is generally upheld "if such public action is justified as promoting the general welfare." 449 U.S. at 163. That is the case here.

Conclusion

For the foregoing reasons, the judgment of the Fifth Circuit should be reversed.

Respectfully submitted,

HENRY C. DINGER, P.C.
GOODWIN, PROCTER & HOAR LLP
Exchange Place
Boston, Massachusetts 02109
(617) 570-1000

*Counsel for the Massachusetts Bar
Foundation, amicus curiae*

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, ET AL.,
Petitioner,

v.

WASHINGTON LEGAL FOUNDATION, ET AL.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

**BRIEF OF AMICI CURIAE IN SUPPORT OF THE
PETITIONERS**

SCOTT HARSHBARGER
*Attorney General
of Massachusetts*

DEBORAH STEENLAND*
Assistant Attorney General
1 Ashburton Place, Room 2019
Boston, Massachusetts 02108
(617) 727-2200, ext.2523
**Counsel of Record*

Additional counsel listed inside

21/98

GRANT WOODS
Attorney General of Arizona

WINSTON BRYANT
Attorney General of Arkansas

RICHARD BLUMENTHAL
*Attorney General of
Connecticut*

ROBERT A. BUTTERWORTH
Attorney General of Florida

THURBERT E. BAKER
Attorney General of Georgia

MARGERY S. BRONSTER
Attorney General of Hawaii

ALAN G. LANCE
Attorney General of Idaho

JAMES E. RYAN
Attorney General of Illinois

JEFFREY A. MODISSETT
Attorney General of Indiana

THOMAS J. MILLER
Attorney General of Iowa

ALBERT B. CHANDLER, III
Attorney General of Kentucky

RICHARD P. IEYOUNG
Attorney General of Louisiana

ANDREW KETTERER
Attorney General of Maine

J. JOSEPH CURRAN, JR.
Attorney General of Maryland

FRANK J. KELLEY
Attorney General of Michigan

HUBERT H. HUMPHREY III
Attorney General of Minnesota

JEREMIAH W. (JAY) NIXON
Attorney General of Missouri

JOSEPH P. MAZUREK
Attorney General of Montana

FRANKIE SUE DEL PAPA
Attorney General of Nevada

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on back inside cover

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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1996

No. 96-1578

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ, HON. JACK
HIGHTOWER, HON. NATHAN L. HECHT, HON. LLOYD DOGGET, HON.
JOHN CORNYN, HON. BOB GAMMAGE, HON. CRAIG T. ENOCH, HON.
ROSE SPECTOR, TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION, AND
W. FRANK NEWTON, IN HIS OFFICIAL CAPACITY AS CHAIRMAN OF THE
TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION, *Petitioners,*

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R. SUMMERS, AND
MICHAEL J. MAZZONE, *Respondents.*

STATEMENT OF AMICUS INTEREST

The Commonwealth of Massachusetts and the undersigned 34 amici states have two direct interests in the resolution of this case. First, each of the amici states has an Interest on Lawyers Trust Accounts ("IOLTA") program. These IOLTA programs have been

created either by a state legislature or by a judicial order or rule of a state's highest court.¹

The IOLTA programs have provided hundreds of millions of dollars that are principally directed to the provision of legal services to indigent families and individuals. In this way, states have secured significant financial assistance in addressing the states' important interests in the improvement of the administration of justice and the delivery of legal services to those who cannot afford them. If affirmed, the decision of the Fifth Circuit in this case would place the states' IOLTA programs in jeopardy.

The states' second interest concerns the proper application of the Fifth Amendment's Taking Clause, which requires that a state pay just compensation when it takes private property for a public use. In order to present a valid takings challenge, however, claimants must

¹ All fifty states and the District of Columbia have adopted IOLTA programs. The states implemented IOLTA programs on the following dates: Florida (1981); Idaho (1982); Maryland (1982); California (1983); Colorado (1983); Delaware (1983); Georgia (1983); Hawaii (1983); Illinois (1983); Minnesota (1983); Nevada (1983); New Hampshire (1983); New York (1983); North Carolina (1983); Oklahoma (1983); Utah (1983); Vermont (1983); Virginia (1983); Arizona (1984); Arkansas (1984); Connecticut (1984); Iowa (1984); Kansas (1984); Mississippi (1984); Missouri (1984); Nebraska (1984); New Mexico (1984); Rhode Island (1984); South Dakota (1984); Tennessee (1984); Texas (1984); Louisiana (1985); Massachusetts (1985); Montana (1985); Ohio (1985); South Carolina (1985); Washington (1985); Alaska (1986); Kentucky (1986); Maine (1986); Michigan (1986); Alabama (1987); New Jersey (1987); North Dakota (1987); Wisconsin (1987); Pennsylvania (1988); Oregon (1989); West Virginia (1989); Wyoming (1990). An IOLTA program in Indiana has been approved and is pending implementation. The District of Columbia implemented an IOLTA program in 1985. ABA/BNA, *Lawyers' Manual on Professional Conduct*, § 45:201 (1997).

first show that they have a property interest entitled to recognition under the Fifth Amendment. *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124-25 (1978). In this case, the Fifth Circuit incorrectly determined that the plaintiffs have a constitutionally protected property interest in the interest generated in IOLTA accounts. An overbroad application of the term "property," such as is found in the Fifth Circuit's decision here, extends the protection of the Fifth Amendment beyond its intended scope, improperly exposing the states to unwarranted takings challenges.

SUMMARY OF ARGUMENT

The states have an important interest in improving the quality of legal services available to their residents. IOLTA programs significantly advance this goal by contributing funds for use in improving the administration of justice and delivering legal services to poor families and individuals.

The Fifth Circuit erred when it found that a client whose funds are placed in an IOLTA account has a constitutionally recognized property interest in the interest earned in that account. A client has no legitimate claim of entitlement to the interest earned in an IOLTA account since that interest is entirely a creation of the IOLTA program.

ARGUMENT

I. THE STATES HAVE IMPORTANT INTERESTS IN PROVIDING OPEN ACCESS TO THE COURTS AND IN THE ADMINISTRATION OF JUSTICE.

Like the constitutions of many states, the Massachusetts Declaration of Rights sets forth the Commonwealth's important interest in providing free and open access to its courts:

Every subject of the commonwealth ought to find a certain remedy, by having recourse to the laws, for all injuries or wrongs which he may receive in his person, property or character. He ought to obtain right and justice freely, and without being obliged to purchase it; completely, and without any denial; promptly, and without delay, conformably to the laws.

Mass. Const. pt.1, art.11.

The states also have an important interest in the administration of justice. *See, e.g.*, Cal. Bus. & Prof. Code Ann. § 6031(a)(West Supp. 1990)(broad statutory mission of the State Bar of California is to promote the administration of justice); and *Matter of Bar of Wisconsin*, 485 N.W.2d 225, 226 (Wis. 1992)(significant aspect of public interest is the efficient and effective administration of justice).

The important nature of these state interests has been recognized by this Court. In *Keller v. State Bar of California*, 496 U.S. 1, 14 (1990), the Court held that the State's interest in regulating the legal profession or improving the quality of legal services justified the compelled association which resulted from mandatory membership in the state bar. Likewise, in *Lathrop v. Donohue*, 367 U.S. 820, 842 (1961), the Court held that "improving the quality of legal service

available to the people of the State . . . is a legitimate end of State policy."

The money earned in IOLTA accounts provides significant assistance to the states in achieving these goals. Each year since 1990, the IOLTA programs combined have provided approximately \$100,000,000 to charitable entities, typically non-profit legal organizations. The contribution of funds raised in IOLTA accounts has been especially important to the amici states during the past several years when funding for the Legal Services Corporation, which provides federal funds for legal services, has been significantly reduced.

Interest generated in IOLTA accounts has been used to assist the states in providing meaningful access to the justice system. In Massachusetts, for example, court rules regulating the IOLTA program require that the interest earned in IOLTA accounts be directed "for use in (1) improving the administration of justice or (2) delivering civil legal services to those who cannot afford them." Supreme Judicial Court Rule 3:07, Disciplinary Rule 9-102(c)(2)(a). Indeed, over 90% of the money earned in IOLTA programs nationally has supported the delivery of legal services, including pro bono legal services, to indigent families and individuals. Other activities supported by IOLTA funds include alternative dispute resolution programs, victim services programs, minority law recruitment programs, and law school scholarship programs. American Bar Association Commission on Interest on Lawyers' Trust Accounts, *IOLTA Handbook* (1997) at p.2.

Thus, the IOLTA programs make a substantial contribution toward achieving the goals of improving the administration of justice and providing civil legal services to low-income individuals who cannot afford to hire a lawyer. The importance of the IOLTA programs to the amici states and their indigent citizens cannot be overstated.

II. THE FIFTH CIRCUIT ERRED WHEN IT DETERMINED THAT CLIENTS HAVE A PROPERTY INTEREST IN THE INTEREST GENERATED IN IOLTA ACCOUNTS.

With the exception of the Fifth Circuit's decision below, legal challenges asserting that IOLTA programs are unconstitutional have failed. The reason is simple: since IOLTA programs do not affect or impair any property interest of the client, there is no violation of the Fifth Amendment to the United States Constitution. All state courts that have decided the issue, as well as the First and Eleventh Circuit Courts of Appeals, have reached this conclusion. While the Fifth Circuit properly began its analysis by noting that "[s]tate law defines 'property' . . .," *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, 94 F.3d 996, 1000 (5th Cir. 1996), the Court erred when it determined that the interest earned on IOLTA accounts is the property of the clients whose money is held in those accounts.

A. Clients Whose Funds Are Placed In IOLTA Accounts Do Not Have A Reasonable Claim of Entitlement To The Interest Generated In Those Accounts.

"Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law — rules or understandings that secure certain benefits and that support claims of entitlement to those benefits." *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). Thus, "a mere unilateral expectation or an abstract need is not a property interest entitled to protection." *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 161 (1980). Rather, a person must have "a legitimate

claim of entitlement" in order for an interest to qualify as a property interest for constitutional purposes. *Board of Regents*, 408 U.S. at 564. As this Court has noted, takings challenges have been dismissed even where a challenged governmental action caused economic harm, if the action did not "interfere with interests that were sufficiently bound up with the *reasonable* expectations of the claimant to constitute 'property' for Fifth Amendment purposes." *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124-25 (1978) (emphasis added). See also, *Hooker v. Burr*, 194 U.S. 415, 419 (1904) (Constitution does not protect "abstract rights").

A client whose funds are placed in an IOLTA account cannot properly claim entitlement to the interest generated in that account because there is no reasonable expectation that that interest belongs to the client. This is because the interest generated by IOLTA client fund deposits is entirely a creation of the IOLTA program.

The Massachusetts IOLTA program is typical of IOLTA programs generally.² The Massachusetts IOLTA program is created by a rule of the Massachusetts Supreme Judicial Court.³ Supreme Judicial

² Variations in the IOLTA programs include whether the attorneys' participation in the program is mandatory or voluntary. Compare, New Mexico Rules of Court, Rule of Professional Conduct 16-115(D) (establishing voluntary IOLTA program) with *Petition of Minnesota State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982) (establishing mandatory IOLTA program). In addition, some programs include an opt-out provision, which provides that all lawyers must take part in the program unless they affirmatively give notice that they decline to participate. See, e.g., Alabama Rules of Professional Conduct, Rule 1.15(f), (g).

³ Forty-five of the IOLTA programs were created by an order of the respective state's highest court. The IOLTA programs in California, New York, Connecticut, Ohio and Maryland were created by the state legislature.

Court Rule 3:07 contains the "Canons of Ethics and Disciplinary Rules Regulating The Practice Of Law." Disciplinary Rule 9-102(C) regulates attorneys' handling of client funds. The Court rule neither requires clients to give any funds to attorneys nor requires attorneys to hold any funds for clients; it does not alter the relationship between lawyers and clients. The rule merely regulates the handling of some client funds that are accepted by attorneys.

Pursuant to this rule, if an attorney decides to accept client funds, those funds must be deposited into one of two types of interest bearing accounts. DR 9-102(C). Generally speaking, client funds are deposited in an individual client account with the interest payable as directed by the client. It is only those client funds held by the lawyer "which in the judgment of the lawyer are nominal in amount, or are to be held for a short period of time," that are to be deposited in an IOLTA account. *Id.* Interest from the IOLTA account is then paid, net of expenses, as directed by the attorney to a charity approved by the Supreme Judicial Court "for the use in (1) improving the administration of justice or (2) delivering civil legal services to those who cannot afford them." DR 9-102(c)(2)(a).

The funds pooled in IOLTA accounts are either so small or held for such a short period of time that it is not feasible to place them in separate interest bearing accounts. *Petition by Massachusetts Bar Ass'n*, 395 Mass. 1, 6, 478 N.E.2d 715, 718 (1985). Funds are deposited in an IOLTA account only if and when the lawyer determines that the administrative and transactional costs of placing the funds in a separate account exceed the interest likely to be generated. Previously, these client funds were typically placed in non-interest bearing checking accounts, where they could "benefit neither the attorney nor the client but simply redound[ed] to the benefit of the depository institution." *Id.* See also, ABA Formal Opinion 348 (1982), *reprinted in* 68 A.B.A. J.1502 (1982).

In these circumstances, where, in the absence of the IOLTA program, the client's funds would not earn interest payable to the client, a client has no reasonable claim of entitlement to the interest that is earned in an IOLTA account. Accordingly, the Fifth Circuit erred in this case when it determined that the plaintiffs have a constitutionally cognizable property interest.

*B. State Courts Have Appropriately Rejected
Constitutional Challenges To IOLTA
Programs.*

Each state court that has reached the issue of whether the regulation of interest earned by IOLTA programs constitutes a taking under the Fifth Amendment has determined that the clients whose funds were at issue did not have a constitutionally recognized property interest in the interest generated by these accounts.⁴

⁴ See, *Matter of Interest on Lawyers' Trust Accounts*, 283 Ark. 252, 675 S.W.2d 355 (1984), *rev'g*, 279 Ark. 84, 648 S.W.2d 480 (1983); *Carroll v. State Bar of California*, 166 Cal. App.3d 1193, 213 Cal. Rptr. 305 (Cal App. 4th Dist.), *cert. denied sub nom. Chapman v. State Bar of California*, 474 U.S. 848 (1985); *Matter of Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981); *Petition by Massachusetts Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985); *Petition of Minnesota State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); *Petition of New Hampshire State Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258 (1982); *Matter of Interest on Lawyer's Trust Accounts*, 672 P.2d 406 (Utah 1983); and *Matter of the Adoption of Amendments to CPR DR 9-102 IOLTA*, 102 Wash.2d 1101 (1984). While the Indiana Supreme Court declined to authorize an IOLTA program in *Matter of Indiana State Bar*, 550 N.E.2d 311 (Ind. 1990), that decision does not rest on constitutional grounds, but on an analysis of the Indiana Rules for Discipline of Attorneys and Rules of Professional Conduct. Indiana has subsequently approved an IOLTA program.

The Supreme Court of Florida was the first state court to determine that the earnings on clients' funds placed in IOLTA accounts are not "property" for the purpose of the Fifth Amendment. *Matter of Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981). There the court determined that "no client is compelled to part with 'property' by reason of a state directive, since the [IOLTA] program creates income where there had been none before, and the income thus created would never benefit the client under any set of circumstances." *Id.* at 395.

Subsequently, in *Carroll v. State Bar of California*, 166 Cal. App. 3d 1193, 213 Cal Rptr. 305 (Cal. App. 4th Dist.), *cert. denied sub nom. Chapman v. State Bar of California*, 474 U.S. 848 (1985), a California Court rejected a Fifth Amendment challenge to that state's mandatory IOLTA program. The *Carroll* court declined to recognize any client property interest in the interest generated by IOLTA accounts, reasoning that:

[where] by definition, [the] transactional costs exceed or equal the total interest income generated, the clients suffer no loss for which they are entitled to compensation. The abstract right to control where interest earned on person's money may be funneled is not an economic right subject to monetary compensation.

213 Cal. Rptr. at 311.

Other state courts have followed the reasoning articulated by the Florida and California courts, finding that interest earned in an IOLTA account is not a property interest cognizable under the constitution. *See, e.g., Petition of Massachusetts Bar Ass'n*, 395 Mass. 1, 6, 478 N.E.2d 715, 718 (1985) ("interest on nominal or short-term trust deposits held in trust accounts is not property for

constitutional purposes") and *Petition of Minnesota Bar Ass'n*, 332 N.W.2d 151, 158 (Minn. 1982) (no "property" is taken from client under IOLTA program).

Further, forty-five states have adopted IOLTA programs through an order or rule of the state's highest court. In approving the IOLTA program, these state courts have implicitly rejected the claim that the IOLTA programs are unconstitutional.

Accordingly, the state courts that have examined the issue have determined that clients are not deprived of "property" when nominal or short-term deposits are placed in IOLTA accounts. The state courts have consistently determined therefore that clients do not have a legitimate claim of entitlement in the interest earned in IOLTA accounts.⁵

⁵ The reasoning of the two other Circuit Courts of Appeals to have considered the issue is consistent with that of the state courts. In *Cone v. State Bar of Florida*, 819 F.2d 1002, 1007 (11th Cir.), *cert. denied*, 484 U.S. 917 (1987), the Eleventh Circuit held that the plaintiff did not have a legitimate claim of entitlement to the interest earned in an IOLTA program, reasoning:

Here, there was no taking of any property of the plaintiff. Standing alone, her deposit in the IOTA account could not earn anything. By combining all such deposits, interest income has been created which was not within the legitimate expectations of the owner of any one of the principal amounts.

See also, Washington Legal Foundation v. Massachusetts Bar Ass'n, 993 F.2d 962 (1st Cir. 1993) (rejecting the claim that plaintiffs had a protected property right to exclude other from the beneficial use of funds deposited in IOLTA accounts).

C. *The Fifth Circuit Incorrectly Applied This Court's Reasoning In Webb's Fabulous Pharmacies, Inc. v. Beckwith.*

The Fifth Circuit rejected the reasoning of the courts cited above on the grounds that that reasoning did not give proper weight to this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980). The Fifth Circuit's analysis of *Webb's*, however, is incorrect as it fails to recognize the express limitations of the scope of that decision.

In *Webb's*, this Court considered whether it was constitutionally permissible for a county to take the interest accruing on an interpleader fund deposited in the registry of the county court where a fee was also charged for the clerk's services in establishing the fund. The issue arose when a purchaser, who agreed to buy *Webb's Fabulous Pharmacies, Inc.* for over \$1.8 million, discovered at the closing that *Webb's* debts appeared to be greater than the purchase price. *Id.* at 156. The purchaser filed a complaint of interpleader in the appropriate county court, interpleading *Webb's* and *Webb's* creditors and submitting the purchase price to the court. While the case was being resolved, the interest earned on the interpleader fund exceeded \$100,000. *Id.* at 158.

The Court found that the creditors had a state-created property right to their respective portions of the fund. *Id.* at 161. After determining that the state had not offered any reasonable basis to support the taking of the interest earned by the interpleader fund, the Court found that the county had violated the Taking Clause of the Fifth Amendment. The Court, however, expressly noted the limited scope of its holding, stating:

We hold that under the narrow circumstances of this case — where there is a separate and distinct state

statute authorizing a clerk's fee "for services rendered" based upon the amount of principal deposited; where the deposited fund itself concededly is private; and where the deposit in the court's registry is required by state statute in order for the depositor to avail itself of other statutory protection from claims of creditors and others — Seminole County's taking unto itself, under § 28.33 and 1973 Fla. Laws, ch. 73-282, the interest earned on the interpleader fund while it was in the registry of the court was a taking violative of the Fifth and Fourteenth Amendments. We express no view as to the constitutionality of a statute that prescribes a county's retention of interest earned, where the interest would be the only return to the county for services it renders.

Id. at 164-65.

Ignoring the limited nature of the decision, the Fifth Circuit cited *Webb's* to support a general rule that a property interest exists in accrued interest "simply because '[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property.'" 94 F.3d at 1002 (quoting *Webb's Fabulous Pharmacies, Inc.*, 449 U.S. at 164). In reaching this conclusion, the Fifth Circuit overlooked significant factual distinctions between the interest that accrued on the interpleader fund in *Webb's* and the interest that is generated in IOLTA accounts. In *Webb's*, the \$1.8 million that was placed in the interpleader fund during the resolution of the litigation generated over \$100,000 of interest. Funds that are placed in IOLTA accounts, however, are either nominal in amount or are to be held for a short period of time so that, held individually, the funds would not net interest. While the creditors in *Webb's* may have had a reasonable expectation in the interest generated on the

interpleader fund, no such reasonable expectation exists for the clients whose funds are placed in IOLTA accounts.

Further, the Fifth Circuit's analysis cannot be reconciled with the Court's caveat concerning the limitation of its holding. Rather than developing a broad, general rule, this Court limited its holding to the "narrow circumstances of this case." 449 U.S. at 164. Indeed, the Fifth Circuit's approach is contrary to *Penn Central Transportation Co. v. New York City*, where the Court explicitly noted that it has not developed any "set formula" for determining whether a taking has occurred, looking instead to the particular factual circumstances of each case. 438 U.S. 104, 124 (1978).

Finally, the Fifth Circuit's reading of *Webb's* is inconsistent with the Court's statement that "[w]e express no view as to the constitutionality of a statute that prescribes a county's retention of interest earned, where the interest would be the only return to the county for services it renders." *Webb's Fabulous Pharmacies, Inc.*, 449 U.S. at 165. Thus, contrary to the general rule adopted by the Fifth Circuit in this case, the *Webb's* court acknowledged that in some circumstances, it may in fact be appropriate for the government to retain interest earned on privately held principal. Consistent with the reasoning in *Webb's*, such a result would depend upon whether the particular facts allowed the claimants to form a legitimate expectation in that interest. Inasmuch as the claimants in this case had no reasonable expectation in the interest generated in IOLTA accounts, the state court have appropriately rejected the constitutional challenges to the IOLTA programs and the Fifth Circuit's decision, based on a misapplication of the term "property," should be reversed.

CONCLUSION

For the foregoing reasons, the amici states respectfully request that the Court reverse the Fifth Circuit decision in this case.

Respectfully submitted,

SCOTT HARSHBARGER
Attorney General of Massachusetts

DEBORAH STEENLAND*
Assistant Attorney General
One Ashburton Place
Boston, Massachusetts, 02108
(617) 727-2200

**Counsel of Record*

Dated: August 25, 1997

Additional counsel listed on inside cover.

PHILIP T. McLAUGHLIN
*Attorney General of New
Hampshire*

DENNIS C. VACCO
Attorney General of New York

MICHAEL F. EASLEY
*Attorney General of North
Carolina*

HEIDI HEITKAMP
*Attorney General of North
Dakota*

BETTY D. MONTGOMERY
Attorney General of Ohio

W.A. DREW EDMONDSON
Attorney General of Oklahoma

HARDY MYERS
Attorney General of Oregon

D. MICHAEL FISHER
*Attorney General of
Pennsylvania*

JEFFREY B. PINE
*Attorney General of Rhode
Island*

JOHN KNOX WALKUP
*Attorney General & Reporter
of Tennessee*

JAN GRAHAM
Attorney General of Utah

WILLIAM H. SORRELL
Attorney General of Vermont

CHRISTINE O. GREGOIRE
*Attorney General of
Washington*

DARRELL V. MCGRAW, JR.
*Attorney General of West
Virginia*

WILLIAM U. HILL
Attorney General of Wyoming

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, ET AL.,

Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, ET AL.,

Respondents.

On Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE COLUMBUS, AKRON, CINCINNATI,
CLEVELAND, DAYTON, TOLEDO, CUYAHOGA COUNTY,
AND STARK COUNTY BAR ASSOCIATIONS; THE LEGAL AID
SOCIETIES OF COLUMBUS, CINCINNATI, CLEVELAND,
DAYTON, TOLEDO, ASHTABULA COUNTY, BUTLER-
WARREN, NORTHEAST OHIO, AND STARK COUNTY;
CHILDREN'S DEFENSE FUND—OHIO; THE COALITION ON
HOMELESSNESS AND HOUSING IN OHIO; OHIO HUNGER
TASK FORCE; OHIO COUNCIL OF CHURCHES; CATHOLIC
CONFERENCE OF OHIO; OHIO DOMESTIC VIOLENCE
NETWORK; PRO SENIORS; ADVOCATES FOR BASIC LEGAL
EQUALITY; OHIO STATE LEGAL SERVICES ASSOCIATION
AS AMICI CURIAE IN SUPPORT OF PETITIONERS

RICHARD A. FRYE
CHESTER, WILLCOX & SAXBE
17 South High Street, Suite 900
Columbus, Ohio 43215
(614) 221-4000

RICHARD A. CORDRAY
Counsel of Record
4900 Grove City Road
Grove City, Ohio 43123
(614) 539-1661

Attorneys for the Amici Curiae

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AS AMICI CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF THE AMICI CURIAE

The Columbus Bar Association and the other *amici* bar associations are non-profit organizations that were created to deal with issues involving the governance and responsibilities of the practicing bar. Among these responsibilities, in their view,

is the need to address the persistent problem of assuring access to legal services for the economically disadvantaged. In this regard, the *amici* bar associations have been directly involved with the "Interest on Lawyers' Trust Account Program" ("IOLTA" program) in the State of Ohio, which has emerged as an innovative means of creating funding for legal services to the poor out of sources that could not be utilized to generate any income prior to the institution of this program.

The Legal Aid Society of Columbus, along with the other *amici* legal aid groups, are non-profit organizations that are committed to providing legal aid services to those who ordinarily do not have adequate access to such services in our society, usually because of personal financial constraints. In recent years, as the Federal government's financial support for these services has declined and become more uncertain, the *amici* legal aid societies, like other similar groups around the country, have been able to draw upon the resources provided by IOLTA programs and other sources to continue their work. If IOLTA programs are disabled by decisions like the ruling of the court below, then the continued activities of non-profit organizations like the *amici* legal aid societies will be jeopardized. The consequent harm to those who lack the resources to have meaningful access to our courts is obvious, and would cause them to suffer even greater difficulty in realizing the constitutional promise that they should have the "equal protection of the laws."

The other *amici* groups who join this brief are either direct consumers of legal aid services financed by the Ohio IOLTA program or regularly refer individuals who make use of those services because they lack any other recourse in obtaining meaningful access to the courts. Children Defense Fund—Ohio is committed to improving conditions for children, including many who have been abandoned, abused, or neglected, and thus require legal assistance. The Coalition on Homelessness and

Housing in Ohio and the Ohio Hunger Task Force address on a daily basis the needs of Ohio citizens who lack basic housing and nourishment, let alone access to legal services to aid them in securing their basic rights and entitlements. The members of the Ohio Council of Churches and the Catholic Conference of Ohio care for individuals and families who sometimes require access to essential legal services they cannot afford, for a great variety of reasons. The Ohio Domestic Violence Network works with victims of domestic violence who often suffer because of systemic failures in the legal process, including their inability to obtain legal representation to seek the protections afforded by the law. Pro Seniors focuses on the concerns of elderly Ohio citizens, who have their own unique legal needs and problems and yet sometimes lack the ability to afford meaningful representation in our courts. All of these groups agree upon the critical need for state IOLTA programs, which provide funding to assure the wider availability of basic legal services for the poor and disadvantaged.

For these reasons, the *amici curiae* have a direct interest in the constitutional issues raised in this case, the resolution of which will dictate whether IOLTA programs will be able to continue to operate in every jurisdiction where they have been approved and implemented. This broad coalition of groups is representative of the range of people who would be adversely affected if this source of funding for legal services were to be curtailed; it vividly demonstrates that IOLTA programs are of increasing importance to assure the continued availability of these services to many individuals who cannot otherwise afford to protect their legal rights by hiring a lawyer on their own.¹

¹ Counsel for petitioners and respondents have consented to the filing of this brief. Letters evidencing such consent are on file in the Clerk's office.

QUESTION PRESENTED

Whether state IOLTA programs, which aggregate client trust funds that would not otherwise earn any interest so that the interest on the combined funds can be utilized by non-profit organizations whose primary purpose is the direct provision of legal services to the poor, constitute an unconstitutional "taking" of property for public use without "just compensation."

SUMMARY OF ARGUMENT

IOLTA programs, which have been adopted in essentially the same form everywhere in the country, do not effect an unconstitutional "taking." By definition, all of the amounts deposited under the terms of an IOLTA program are funds that would be unable to earn interest on their own account, either because the amounts are too insignificant or because the deposits are too transitory to permit the accrual of interest that would make it feasible, in light of banking restrictions and administrative charges, to earn any actual return. Because of this central fact, which is undisputed in this case, IOLTA programs do not effect a "taking" of any cognizable "property interest" within the meaning of the Fifth and Fourteenth Amendments. The program simply creates income where there had been none before, and the income thus created would never benefit the client under any set of circumstances.

Even if the Court were to find that IOLTA programs did somehow effect a "taking" of property within the meaning of the constitutional terms, that result is not accomplished without "just compensation." Under the two tests that the Court has applied to determine the amount of "just compensation" in different circumstances—the "fair market value" test and the "value to the owner" test—the amount of earnings on funds that are eligible for state IOLTA programs is zero. The Court has consistently rejected the application of a "value to the taker"

measure for just compensation. Such a measure would compensate what is acquired, not what is taken, and thus would be directly inconsistent with the text of the Takings Clause. Moreover, the Court has held in various contexts that the government is not required to provide compensation to the property owner for elements of the property's value that the government itself has created, which is obviously true of the IOLTA program itself.

ARGUMENT

IOLTA programs, which have been adopted in essentially the same form everywhere in the country, *see* Pet. 3, do not effect an unconstitutional "taking." The key facts underlying this case were established in the District Court, and were not disputed by the parties. *See Washington Legal Found. v. Texas Equal Access to Justice Found.*, 873 F. Supp. 1, 4 (W.D. Tex. 1995), *rev'd*, 94 F.3d 996 (5th Cir. 1996), *cert. granted*, 117 S. Ct. 2535 (1997). The IOLTA program concerns client funds that, for various reasons, have been tendered to attorneys for safekeeping. Under the rules governing all IOLTA programs, each such attorney is obliged to determine whether the funds entrusted to him or her "can be deposited into an account that could reasonably be expected to earn an amount of interest sufficient to offset the cost of establishing and maintaining the account." *Id.* (quoting Texas State Bar IOLTA Rule 6). Only funds that do not fall within this category are eligible for treatment as IOLTA funds.

By definition, therefore, all of the amounts deposited under the terms of an IOLTA program are funds that would be unable to earn interest on their own account, in view of applicable banking restrictions, administrative charges, service charges, accounting costs, and tax reporting costs. *See* 873 F. Supp. at 4. Because these funds are either nominal in amount or held only for a short term, there is simply no possibility that these

funds would be able to earn any net interest income that could benefit the individual clients for whom the funds are held. *Id.* Once again, it bears emphasis that this central fact is undisputed in this case.²

I. STATE IOLTA PROGRAMS ARE BASED ON FUNDS THAT COULD NOT EARN INTEREST IN THE ABSENCE OF THE IOLTA PROGRAM ITSELF, AND HENCE DO NOT EFFECT AN IMPROPER "TAKING" OF PROPERTY.

A. The Court Below Misapplied This Court's Holding in the *Webb's* Case.

The court below decided this case incorrectly, and in a manner that "contradicts every other court in the country that has addressed this issue," *Washington Legal Found. v. Texas Equal Access to Justice Found.*, 106 F.3d 640, 641 (5th Cir. 1996) (denying rehearing and rehearing *en banc*) (Benavides, J., dissenting), largely because it misconstrued the effect of this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980). In that case, the Court addressed the issue of "whether it is constitutional for a county to take as its own, under the authority of a state statute, the interest accruing on an interpleader fund deposited in the registry of the county court, when a fee, prescribed by another statute, is also charged for the clerk's services in receiving the fund into the registry." *Id.* at 155-56.

² The District Court took special pains to note that there was no genuine issue of material fact concerning whether "sub-accounting is a practical means of generating net interest for clients who deposit small amounts of money with their attorney" because it was conceded that "any type of account that can earn interest beyond the costs of maintaining such account is beyond the scope of IOLTA's coverage." 873 F. Supp. at 4 n.2.

The proper construction of this Court's decision in the *Webb's* case, as it bears upon the validity of state IOLTA programs, was set out by the Florida Supreme Court only a year after that decision was rendered. *See Matter of Interest on Trust Accounts*, 402 So. 2d 389 (Fla. 1981). In the course of its opinion rejecting the claim that Florida's IOLTA program constituted an improper taking, the court cogently explained why the principles of the *Webb's* decision were most consistent with this result.

In *Webb's*, a client was obliged by law to tender the \$1,800,000 purchase price of a business to the clerk of the court in an interpleader action. In accordance with state law, those funds were deposited into a distinct interest-bearing account, and they earned more than \$100,000 in interest before the matter was finally resolved. In these circumstances, this Court held that the Takings Clause was violated when the clerk ultimately closed the fund and returned the \$1,800,000 amount of the deposit, but refused to pay out any of the interest accrued by that private fund to the client. *See* 449 U.S. at 160-65.

The Florida Supreme Court noted that the administration of an IOLTA program differs from the circumstances of the *Webb's* case in material respects. Most important is the fact that all of the amounts deposited under the terms of an IOLTA program are funds that would be unable to earn interest on their own account—once again, either because the amounts are too insignificant or because the deposits are too transitory to permit the accrual of interest that would make it feasible, in light of banking restrictions and administrative charges, to earn any actual return. *See Matter of Interest*, 402 So. 2d at 395. Based on this central distinction, the court concluded that the IOLTA program does not effect a "taking" within the meaning of the Constitution:

The most relevant distinction [between an IOLTA program and the *Webb*'s case], plainly, is the fact that no client is compelled to part with "property" by reason of a state directive, since the program *creates income where there had been none before*, and the income thus created would *never benefit the client under any set of circumstances*. . . . It follows that no client has a "property interest," in the constitutional sense, which is being taken from him by this program.

Id. at 395-96 (emphasis added). On this basis, the Florida Supreme Court approved this method of "enhanc[ing] the capability of the legal profession to deliver legal services to the poor," which "has long been a cherished commitment of this Court." *Id.* at 396; *see also, e.g., Petition by Mass. Bar Ass'n*, 478 N.E.2d 715, 718 (Mass. 1985) ("We agree with the Florida court's analysis and conclude that there is no constitutional impediment to the IOLTA proposal"); *Petition of N.H. Bar Ass'n*, 453 A.2d 1258, 1261 (1982) (same).

The threshold issue in this case, as in *Webb*'s, is whether the complaining party has a valid "property right" that has been "taken," which triggers the constitutional command that just compensation be made. This Court closed its opinion in *Webb*'s by cautioning that its holding should not be read to apply outside a situation where "the deposited fund itself concededly is private." 449 U.S. at 164-65. This is obviously not the case with IOLTA funds, which are conceded to be incapable of producing any accrued return whatsoever if the principal were to be deposited in a private fund. *See* pages 4-5, *supra*.

Ignoring these *caveats*, the panel below construed *Webb*'s very broadly to stand for an across-the-board legal principle that interest must follow principal without regard to any of the particular circumstances of the funds deposited or to the methods of administering those funds. *See* 94 F.3d at 1000-01.

But the Eleventh Circuit has provided the decisive answer to this oversimplified approach, noting that "when Justice Johnson observed in *Himely v. Rose*, 9 U.S. (5 Cranch) 313, 319 (1809), that 'interest goes with the principal, as the fruit with the tree,' his illustration necessarily assumed the existence of a fruit-bearing tree." *Cone v. State Bar of Fla.*, 819 F.2d 1002, 1004 (11th Cir.) (other quotes omitted), *cert. denied*, 484 U.S. 917 (1984).

The Eleventh Circuit went on to explain that the funds at issue in *Webb*'s, which "were sufficient in amount, and held for a sufficient period of time, to generate \$90,000 in interest over a year and a half," did "give rise to a legitimate claim of entitlement" to those proceeds. *Cone*, 819 F.2d at 1007. By contrast, the deposits made under the terms of the IOLTA program can produce no net value, for it is conceded that they could not generate any "legitimate expectation of interest exclusive of administrative costs and expenses." *Id.* (internal quotes omitted). The court stressed that the point was *not* that the amount of income generated was slight and therefore subject to some sort of "*de minimis*" exception to the Takings Clause. Instead, the point was that because each individual deposit in the IOLTA program, standing alone, "could not earn *anything*," the program effected "*no taking* of any property" belonging to any individual depositor. *Id.* (emphasis added).

This analysis thus goes to the Court's statement in *Webb*'s that a "mere unilateral expectation" is not "a property interest entitled to protection" under the Constitution. 449 U.S. at 161. In *Webb*'s, the Court held that the creditors who paid in the \$1,800,000 to the private deposited fund "had more than a unilateral expectation," for eventually that fund and any accretions to it, "less proper charges authorized by the court," would be distributed to them. *Id.* Under the specific terms of the IOLTA programs, however, the client does not have any reasonable basis even for a "unilateral expectation" of any

accretions to these funds, which by definition are incapable of earning any interest upon the principal under the circumstances in which these funds are held.

The dissenting judges below also pointed out the panel's misplaced reliance on the *Webb*'s decision. "A careful reading of *Webb*'s makes clear that the existence of interest proceeds *to which the depositors were entitled* was a prerequisite to the Court's decision." 106 F.3d at 643 (emphasis added). Because this Court went out of its way to recognize that any proceeds from the interpleader fund would first have to be reduced by all "proper charges" before they could be distributed to lawful claimants, this strongly suggests that "the state law rule that 'interest follows principal' controls only when interest is earned on the principal or, in other words, when interest proceeds are available." *Id.* (discussing *Webb*'s, 449 U.S. at 161-65). Once again, no such interest proceeds could ever be made available to the client, by definition, under the specific terms of the state IOLTA programs.

B. Plaintiffs Have No Legitimate Property Right or "Claim of Entitlement" to IOLTA Funds.

The dissenting judges below also explained that because the IOLTA funds are not able to generate any income, net of expenses, apart from the organization and operation of the IOLTA program itself, the federal and state courts have consistently held that the complaining parties have no specific and legitimate "claim of entitlement" to funds created by the IOLTA program. 106 F.3d at 1004-05. This approach to the issue draws upon the Court's decisions in the companion cases of *Board of Regents v. Roth*, 408 U.S. 564 (1972), and *Perry v. Sinderman*, 408 U.S. 593 (1972), which rest the constitutional recognition of a valid property interest upon whether a "legitimate claim of entitlement" is made out under state law. *See Roth*, 408 U.S. at 577; *Perry*, 408 U.S. at 601-02.

An analysis based on cases like *Roth* and *Perry* is appropriate because the issue presented in this case is unlike the situation of a physical taking of tangible property. Under the terms of the IOLTA programs, the nominal or transitory nature of the deposited funds does not give rise to any "reasonable investment-backed expectation" that any net proceeds will be generated from their use. *Webb*'s, 449 U.S. at 161. The Court has stressed that such a "property right" must be grounded in "a legitimate claim of entitlement," which cannot exist without a strong element of justified reliance upon the asserted claim. *Roth*, 408 U.S. at 577. In *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984), for example, the Court held that even where a company has valid property rights in protecting its acknowledged trade secrets, no "taking" occurs unless the required disclosure of such information interferes with any "reasonable investment-backed expectations." *Id.* at 1004-14.

Applying this analysis, the dissenting judges below stressed that no "positive rules of substantive law or mutually explicit understandings" were identified to support the plaintiff's *post hoc*, unilateral claim of entitlement to receive interest that was generated solely by the special operations of the IOLTA program. *See* 106 F.3d at 1004-05. Thus there was no basis for finding an unconstitutional taking.

The court below tried to supply this deficiency by devising its own account of "the precise events of the transaction" at issue under the IOLTA programs. 94 F.3d at 1003. It asserted that the IOLTA transaction always involves a two-step process, whereby "a bank pays interest on the account and then deducts fees." *Id.* at 1003. Ignoring the crucial fact that the trial court had found these "fees" and charges to exceed any interest payments generated by any individual client's IOLTA funds, the court concluded that "a property interest attaches the moment that the interest accrues" and remains vested in the owner of the principal. *Id.*

The dissenting judges also refuted this point. Noting in passing that it was uncertain whether "the panel presents an accurate picture of banking practices," they ultimately found this description to be simply irrelevant:

For purposes of a takings clause challenge, a constitutionally cognizable interest in property does not exist in "earnings" from a deposited fund unless and until those earnings can be distributed as proceeds to the fund's beneficiary. Because IOLTA-eligible funds would never produce interest proceeds, earnings from such funds cannot be distributed to the funds' owners. For this reason, the panel's conclusion that a property interest was created after the first step in the bank's process of assigning interest is simply wrong.

106 F.3d at 643-44. See also *Matter of Interest on Lawyers' Trust*, 675 S.W.2d 355, 357 (Ark. 1984) (because "earnings of funds held in trust accounts can benefit neither the attorney nor the client, but simply redound to the benefit of the depository institution," aggregating those funds for the purpose of generating a new source of income to fund legal services to the poor is not a taking of property); *Petition of Minn. State Bar Ass'n*, 332 N.W.2d 151, 158 (Minn. 1982) ("There simply is no 'property' now in existence that would be taken.").

C. The Takings Analysis Adopted in *Penn Central* Also Validates the IOLTA Program.

In a case challenging the Massachusetts IOLTA program, the First Circuit took a slightly different approach in resolving similar constitutional claims, ultimately concluding that the complaining parties did not "possess a recognized property interest which may be protected by the Fifth Amendment." *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962, 973 (1st Cir. 1993).

In reaching this conclusion, the First Circuit applied this Court's formal three-part test, first articulated in *Penn Central Transp. Co. v. New York*, 438 U.S. 104, 124 (1978), and further developed in *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225 (1986), for determining when a government regulation amounts to a taking of property within the meaning of the Fifth and Fourteenth Amendments. Examining the three prongs of this test, the court held: that there was no physical invasion of property rights under such programs; that their "economic impact" on individual clients is negligible; and that they do not interfere "with distinct investment-backed expectations." 993 F.2d at 974-76 (citing *Connolly* and *Penn Central*).

In determining whether claims raised by individual clients to the proceeds generated by IOLTA funds amounted to protected "property" under this approach, the court first ruled that the IOLTA program did not work "a physical invasion of real property" that would constitute a *per se* taking under this Court's precedents. *Id.* at 975.³ The plaintiffs had sought to analogize the purported "taking" effected by the IOLTA program to the kinds of physical invasions of property that had resulted from government regulation of the uses of a marina, see *Kaiser Aetna v. United States*, 444 U.S. 164 (1979), and the mandated attachment of conduits for cable television to private buildings, see *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). Rejecting these arguments, the court found "no logical analogy between the physical invasion of real property, as in *Kaiser* and *Loretto*, and the operation of the IOLTA Rule." 993 F.2d at 975.

³ The court had previously recognized that the Constitution protects both tangible and intangible property rights, but quoted with approval this Court's holding in *Webb's* that "'a mere unilateral expectation or an abstract need is not a property interest entitled to protection.'" 993 F.2d at 973-74 (quoting *Webb's*, 449 U.S. at 161).

The First Circuit also agreed with the Eleventh Circuit's analysis in distinguishing the *Webb*'s case because "the plaintiffs do not have a property right to the interest earned on their funds held in IOLTA accounts." 993 F.2d at 975-76 (citing *Cone*, 819 F.2d at 1006-07). Based on this reasoning, the court dispatched the plaintiffs' taking claims by holding that "the IOLTA program does not occupy or invade the plaintiffs' property even temporarily." *Id.* at 976. This holding was based on the court's determinations that "the IOLTA program leaves the deposited funds untouched," "the funds are always available to clients," and "the interest earned on IOLTA accounts is not the plaintiffs' property." *Id.* In this context, the only conceivable conclusions were that "[t]he property rights claimed by the plaintiffs were intangible," and that the IOLTA program causes no "physical invasion and occupation of their intangible property rights." *Id.*

The court then proceeded to the second and third steps of the *Connolly* test, which it treated together. The complaining parties claimed the right "to control and to exclude others from the beneficial use of funds held by lawyers," which were the only claims that remained open to them once the court had decided that they had no valid right to the interest earned on IOLTA funds. None of these claims, however, could generate any "economic benefit for the plaintiffs because clients would not otherwise be entitled to the interest earned on pooled accounts." 993 F.2d at 976. For the same reasons, the court found that "there are no 'investment-backed' expectations" to be preserved in the context of the IOLTA program. *Id.* (citing *Connolly*, 475 U.S. at 225). Based on its analysis of this Court's three-part test for assessing the effect of a government regulation, therefore, the court ultimately held that "the IOLTA Rule has not caused a taking of plaintiff's property." 993 F.2d at 976.

The First Circuit thus imported the main features of the Eleventh Circuit's analysis of the takings issue into the more

rigorous framework of the three-part test that this Court laid out in the *Penn Central* and *Connolly* decisions. The core of that analysis, once again, is that because individual client funds would not be able to earn interest on their own account, net of expenses and administrative charges, the income generated by the operation of IOLTA programs is not "property" within the meaning of the Takings Clause. In addition, the First Circuit went further to analyze the takings issue from the standpoint applied more generally to other government regulations, and found by the same rationale that individual clients had no legitimate "expectation-backed" expectations to control the use of proceeds that would not have been able to accrue from their own individual fund accounts. *See* 993 F.2d at 973-76.

These conclusions are undoubtedly correct. In the end, the constitutional bottom line is that the state IOLTA programs simply create income where there could have been none before, and the income thus created would never have been able to benefit the client under any circumstances. As a result, there is no infringement of a valid property interest by the operation of these programs.

II. EVEN IF STATE IOLTA PROGRAMS DID CONSTITUTE A "TAKING" OF PROPERTY, ANY SUCH TAKING WOULD NOT BE MADE WITHOUT "JUST COMPENSATION" AND THUS WOULD BE PERMISSIBLE UNDER THE TERMS OF THE TAKINGS CLAUSE.

Even if the Court were to find that IOLTA programs did somehow effect a "taking" of property within the meaning of the constitutional terms, that result is not accomplished without "just compensation." The Court has consistently rejected the application of a "value to the taker" measure for just compensation, and under the two tests that the Court has applied to determine the amount of "just compensation" in

different circumstances—the “fair market value” test and the “value to the owner” test—the amount of earnings on funds that are eligible for state IOLTA programs is zero.

In his dissent below from the order denying rehearing *en banc*, Judge Benavides posed the issue of what compensation is just in the context of IOLTA programs. See 106 F.3d at 644. He observed that “applying Fifth Amendment protections to an asserted property interest that does not have any compensable value is not consistent with the purposes that underlie the Takings Clause — to compensate a property owner for the value of her property that was taken for public use.” *Id.*

This observation is consistent with a long line of decisions by the Court that have explored and delineated the meaning of the “just compensation” requirement. Justice Holmes long ago summarized the proper test under this component of the Takings Clause as a determination of “what has the owner lost, not what has the taker gained.” *Boston Chamber of Commerce v. Boston*, 217 U.S. 189, 195 (1910). The Court has linked this principle to the definition of the term “compensation,” noting, for example, that “[b]ecause gain to the taker” may be “wholly unrelated to the deprivation imposed upon the owner, it must also be rejected as a measure of public obligation to requite for that deprivation.” *Kimball Laundry Co. v. United States*, 338 U.S. 1, 5 (1949). The same principle inheres (to the owner’s benefit) in the Court’s determination of when a taking occurs, for it is “the deprivation of the former owner rather than the accretion of a right or interest to the sovereign [that] constitutes the taking.” *Ruckelshaus*, 467 U.S. at 1004-05.

Indeed, the facts of the *Boston Chamber of Commerce* case, in particular, bear a careful comparison to the facts underlying the IOLTA program. There the City of Boston exercised its power of eminent domain to lay out a public street upon a parcel of land. The ownership rights in this parcel were

divided among several different parties—the Boston Chamber of Commerce owned the fee of the land; a wharf company had an easement of way, light, and air over the land; and a bank held a mortgage on the land, subject to the easement. See 217 U.S. at 193. These parties agreed to take the position in the resulting litigation that the value of the land taken should be assessed as an unrestricted fee. The City refused to assent to this claim, and noted that the easement considerably lessened the value of the underlying fee interest. It was ultimately stipulated by the parties that if the City prevailed in its view of the matter, the amount of just compensation for the parcel would be \$5,000, whereas if the consortium of interests were to prevail, the price would be \$60,000. *Id.*

The Massachusetts state courts held for the City, and this Court affirmed. It began by stating that the “only question to be considered is whether when a man’s land is taken he is entitled by the Fourteenth Amendment to recover more than the value of it as it stood at the time.” 217 U.S. at 194. It noted that the complaining parties were seeking to have their property valued in a manner that presupposed the uniting of their distinct interests, even though it was highly likely and in any event not at all certain that this would ever have occurred without the government’s exercise of its eminent domain authority. In a striking summary of the issue, therefore, the Court observed that the real question was whether, “*by a simple joinder of parties after the taking, the city could be made to pay for a loss of theoretical creation, suffered by no one in fact.*” *Id.* (emphasis added). The Court found this question to be easily answered in favor of the City, commenting that this “statement of the contention seems to us to be enough.” *Id.*

The Court went on, however, to articulate more fully the rationale for this conclusion:

[T]he Constitution does not require a disregard of the mode of ownership—of the state of the title. It does not require a parcel of land to be valued as an unencumbered whole when it is not held as an unencumbered whole. It merely requires that an owner of property should be paid for what is taken from him. It deals with persons, not with tracts of land. And the question is what has the owner lost, not what has the taker gained. We regard it as entirely plain that the petitioners were not entitled as a matter of law to have the damages estimated as if the land was the sole property of one owner, and therefore are not entitled to \$60,000 under their agreement.

217 U.S. at 195.

If the same analysis is applied to the IOLTA programs, it is clear that even if a “taking” were to be found, the amount of “just compensation” required to be paid to parties such as the plaintiffs is zero. Under the rules of these programs, the funds deposited in the IOLTA accounts are either too small or are held for too brief a period to generate any interest income standing on their own. It is *only* the aggregation of these funds under the terms of the IOLTA programs themselves that makes it possible to generate any income at all. As in the *Boston Chamber of Commerce* case, however, the complaining parties here are demanding that the courts assess their property interests in a manner that “disregard[s] the mode of ownership” and treats each distinct account as though it were part of an unencumbered whole when it has never been held, and would never be held, in this fashion apart from the IOLTA program itself. See 217 U.S. at 195. Thus the real question here too is whether, “by a simple joinder of parties after the [assumed] taking, the [government] could be made to pay for a loss of theoretical creation, suffered by no one in fact.” *Id.* at 194. Once again, the mere “statement of the contention” is more than enough to refute it. *Id.*

In other words, as Judge Benavides concluded, the plaintiffs in this case, and any other parties challenging the administration of the various state IOLTA programs, “are entitled to just compensation, *i.e.*, the fair market value of their property. Because the fair market value of the earnings of IOLTA-eligible funds is \$0, the client would be entitled to nothing.” 106 F.3d at 644. Because none of these client funds would be able to earn any net interest on their own, and the only “profit” previously derived from them had redounded to the sole benefit of the depository institutions, both the value to the owner and the fair market value of these accounts is indeed zero. In consequence, no client is “justly entitled” to funds generated by the aggregation of those distinct accounts, which occurs solely under the operation of the IOLTA programs.

The same basic principles can also be gleaned from yet another series of decisions that are applicable here. The Court has long held that when the government effects a taking of property, basic fairness dictates that the government is not required to compensate the property owner for elements of the property’s value that the government itself has created. See, *e.g.*, *United States v. Fuller*, 409 U.S. 488 (1973) (value created by government’s grant of a revocable permit to graze his animals on adjoining Federal lands); *United States ex rel. TVA v. Powelson*, 319 U.S. 266 (1943) (value created was business opportunity dependent on owner’s privilege to use the state’s power of eminent domain).

This longstanding principle extends at least as far back as *McGovern v. City of New York*, 229 U.S. 363 (1913). In that case, the City took title to various parcels of land in order to incorporate them as part of a reservoir. The complaining parties sought to recover as “just compensation” the enhanced value of the land when used for that purpose; in response, the City sought to limit compensation to the fair market value of each parcel at the time it was purchased. *Id.* at 371-72.

This Court sided with the City. Again, a central tenet of its analysis was that there were "hundreds of titles to different parcels of that land," which were only "brought together by a taking under eminent domain." 229 U.S. at 372. The likelihood that this could have occurred by any other means "might be regarded as too remote and speculative to have any legitimate effect upon the valuation." *Id.* As a result, the complaining party "was entitled to be paid only for what was taken from him as the titles stood, and could not add to the value by the hypothetical possibility of a change unless that possibility was considerable enough to be practical consideration and actually to influence prices." *Id.* (citing *Boston Chamber of Commerce*, 217 U.S. at 195).

If those same bounds are applied to the operation of state IOLTA programs, then any alleged "taking" of property would not be compensable because the individual client's funds are, by strict definition, incapable of generating any income net of administrative expenses, and any value derived from the funds is created solely by the operation of the IOLTA program itself. The likelihood that each individual client fund would be aggregated with other funds to generate net interest income, absent the implementation of the IOLTA program, is obviously nil. The complaining parties thus are not entitled to claim the value of that "hypothetical possibility," whose manifestation in concrete form is solely attributable to the government's unilateral action. *McGovern*, 229 U.S. at 372.

* * *

Finally, even though the point is not strictly germane either to the narrow legal determinations of whether a "property interest" exists or what "just compensation" requires under the peculiar circumstances of IOLTA programs, it is impossible to decide this case entirely in a vacuum that would divorce it from its important practical consequences. Over the past two

decades, state IOLTA programs have been implemented in every jurisdiction nationwide, at the behest of thousands of thoughtful attorneys and judges who have shaped and then blessed their implementation. Their operation is of increasing importance to assure the continued availability of legal services to many deserving individuals who cannot afford to hire a lawyer on their own.

As Judge Benavides and the other dissenting judges have pointed out, the ruling below threatens the very survival of the state IOLTA programs, which are "a primary source of funding for public interest legal organizations" at a time "when those organizations are already struggling for their lives financially." 106 F.3d at 641-42. Surely the public interest does not require the Court to sacrifice the substantial benefits of these innovative programs merely for the sake of extending doctrines of property law that were designed to apply in very different circumstances. None of the core principles of the Court's takings jurisprudence would be threatened in the least by upholding the constitutional validity of the unique programs at issue in this case.

CONCLUSION

For the foregoing reasons, as well as those stated by petitioners, the judgment below should be reversed.

Respectfully submitted,

RICHARD A. FRYE
CHESTER, WILLCOX & SAXBE
17 South High Street, Suite 900
Columbus, Ohio 43215
(614) 221-4000

RICHARD A. CORDRAY
Counsel of Record
4900 Grove City Road
Grove City, Ohio 43123
(614) 539-1661

Attorneys for the Amici Curiae

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1997

THOMAS R. PHILLIPS, ET AL.,

Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, ET AL.,

Respondents.

On Writ of Certiorari to the United States Court
of Appeals for the Fifth Circuit

**BRIEF OF ATTORNEYS' BAR ASSOCIATION OF FLORIDA
AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS**

HARVEY M. ALPER
ALPER WALDEN & CRICHTON
112 West Citrus Street
Alamonte Springs, FL 32714
(407) 772-7333

RONALD D. MAINES
(*Counsel of Record*)
R. SHAWN GUNNARSON
MAINES & LOEB, PLLC
2300 M Street, N.W.
Suite 900
Washington, D.C. 20037
(202) 223-2817

Counsel for Amicus Curiae

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INTEREST OF AMICUS CURIAE

Pursuant to Rule 37.3 of this Court, the Attorneys' Bar Association of Florida (ABAF) respectfully submits this brief *amicus curiae* in support of Respondents. Written consent to the filing of this brief has been granted by counsel for the parties, and letters of consent have been lodged with the Clerk.¹

The Attorneys' Bar Association of Florida is a voluntary, statewide bar association created in 1992 by Florida lawyers dissatisfied with the increasing incursion of the mandatory membership Florida Bar into issues of social policy and politics. ABAF members include more than 500 Florida attorneys, many of whom opposed the adoption of a mandatory IOLTA program during a series of arguments before the Florida Supreme Court. Florida is the state where IOLTA had its genesis, following a series of decisions whereby mandatory taking of client interest on trust money held in lawyer trust accounts was gradually permitted. Accordingly, ABAF's perspective should complement the briefs of the parties and their *amici*, and assist the Court in the proper resolution of this case.

SUMMARY OF ARGUMENT

In a well-known work by surrealist M.C. Escher, the observer is confronted by an odd sort of triangle — the "impossible tribar" — which holds together as a drawing purely by means of incorrect connections. The three angles appear normal, but they have been joined together in a false, spatially impossible way. This curious phenomenon is not unlike the argument advanced by opposing *amici* in this case, who, while not disputing the general axiom that interest follows principal, nonetheless urge that Respondents can have no property interest

¹ ABAF states that no counsel for a party authored this brief in whole or in part, and no person or entity other than ABAF made a monetary contribution to the preparation or submission of the brief. SUP. CT. R. 37.6.

in the yield of IOLTA accounts, even though Respondents' property was a necessary condition for the yield to occur. Like the Escher drawing, *amici*'s argument rests on false junctions, the principle one being that Respondents' property interest vanishes because the aggregate yield on pooled funds is a "government-created value." This argument fails for at least two reasons. First, it lacks a principled explanation for why the restructuring of Respondents' property rights *vis a vis* the State automatically occurs merely because the yield on Respondents' deposit has value in the aggregate, but not by itself. Second, the argument rests on a mistaken premise which, if taken as true, eviscerates the fundamental idea that property ownership includes as its most essential feature the right of exclusion. Because the "government-created value" argument is not logically or legally sound, it cannot be used as a rationale for denying that, indeed, interest earned on client trust funds in an IOLTA account is a property interest of the client or lawyer.

ARGUMENT

THE RULE THAT INTEREST IS AN INSEPARABLE INCIDENT OF PRINCIPAL CANNOT BE DEFEATED BY THE "GOVERNMENT-CREATED VALUE" ARGUMENT

In their brief on the merits, Respondents carefully explicate the venerable rule that interest follows principal, and demonstrate the rule's dispositive force in this case. ABAF will underscore Respondents' argument by addressing the contentions of several opposing *amici* who urge that the interest-follows-principal rule is inapplicable in these circumstances because of the structure of the IOLTA program.

In its *amicus* brief, the United States does not dispute as a general matter the validity of the interest-follows-principal rule. Nor does the United States question that the "client funds

underlying the IOLTA program are the property of respondents." Brief of United States at 10. Rather, it urges that in the circumstances of this case, the interest that would otherwise qualify as a cognizable incident of Respondents' property, lacks that attribute because the "interest generated through the IOLTA program is a government-created value." *Id.* at 9. We will refer to this as the "Created-Value" argument. The United States argues, in effect, that the sheer act of IOLTA's aggregation of the yield from principal severs the ownership connection between principal and interest that Respondents otherwise (unquestionably) possess. The American Bar Association's argument rests in large part on the same basic contention. The ABA asserts that Respondents have no cognizable property interest because "nothing is taken from clients and no opportunity to earn income is diverted." Brief of ABA at 12.² Neither of these arguments recognizes the fact that by virtue of individual client sub-accounts, it is now possible for every client to receive such interest as may accrue on the client's attorney trust account deposit. This was not the case when IOLTA was first proposed in the late 1970s and early 1980s. As shown below, however, the Created-Value argument is also invalid because (1) it lacks a principled basis, and (2) it rests on a faulty premise.

A. The Created-Value Argument Lacks A Principled Basis.

1. In Anglo-American jurisprudence, the basic precepts that govern analyses about property rights flow from the foundational work of Wesley Hohfeld's explication of rights and A.M. Honore's description of the incidents of ownership.

² Similarly, the *amici* comprising various state bar organizations argue that Respondents cannot show a "legitimate claim of entitlement" as to IOLTA-earned interest, and thus can show no cognizable property interest. Brief of Amici Curiae at 14.

WESLEY N. HOHFELD, FUNDAMENTAL LEGAL CONCEPTIONS AS APPLIED IN JUDICIAL REASONING AND OTHER LEGAL ESSAYS 67 (Walter W. Cook ed., 1923); A.M. Honore, *Ownership*, in OXFORD ESSAYS IN JURISPRUDENCE 107, 112 (A.G. Guest ed., 1961). Members of this Court have often assumed the validity of Hohfeld's schema in their own reasoning. See, e.g., *Golden State Transit Corp. v. City of Los Angeles*, 110 S.Ct. 444, 452 (1989) (Kennedy, J., dissenting) ("I would prefer to follow the familiar Hohfeldian terminology" of correlatives); *U.S. v. Richardson*, 94 S.Ct. 2940, 2959 (1974) ("[R]espondent is in the position of a traditional Hohfeldian plaintiff"); *Zablocki v. Redhail*, 98 S.Ct. 673, 684 (1978) (Stewart, J., concurring in the judgment).

Under the conventional Hohfeldian analysis, any right *in rem* must be regarded as a myriad of personal rights between individuals. See, e.g., *Nollan v. California Coastal Comm'n*, 107 S.Ct. 3141, 3162 (1987) (Brennan, J., dissenting) (Property is "more accurately described as being inextricably part of a network of relationships.") As one commentator has put it, "[M]y ownership of a car should not be regarded as a legal relationship between me and a thing, the car, but as a series of rights I hold against all others, each of whom has a correlative duty not to interfere with my ownership of the car, damaging it, stealing it, and so on." J.E. Penner, *The "Bundle of Rights" Picture of Property*, 43 U.C.L.A. L. REV. 711, 742 (1996). Property thus constitutes a complex of normative relations between the property-holder and others. This focus on the relational aspect of property assumes as axiomatic, that when the relations between a property-owner and others are restructured, there is a principled rule in play that justifies such action. In other words, the restructuring cannot occur in an arbitrary way without upsetting the reasonable, correlative expectations that hold the framework of property rights together. This is the point of the Court's phrase in *Pennsylvania Coal Co. v. Mahon*, 43 S.Ct. 158 (1922), that the analysis of property disputes as between an

individual and the State must ask whether "an average reciprocity of advantage" has been "secur[ed]." *Id.* at 162.

2. The Created-Value argument fails to incorporate this understanding of the nature of property rights. Applying the relational model to this case makes clear that the State's acquiring ownership of Respondents' property, simply by virtue of the extra value the IOLTA program creates, is incoherent. Nothing in the Created-Value argument explains *why* that restructuring of the respective rights and duties of the parties automatically occurs *merely because* the yield on Respondents' deposit has value in the aggregate. There is no logical principle that explains the basis for the restructuring of the relationship — the fact that, in any normal circumstances the incidents of Respondents' property are preserved, whereas here they are stripped.

The point can be illustrated this way. Suppose the property in question were a tiny piece of farmland. Although the land is so small that the food crop it yields is not worth the cost of planting, the landowner plants potatoes for his own pleasure. The State decides, however, that the aggregation of such yields from a large number of similar landowners could be used for purposes the State deems to be in the public interest. The State argues that since the aggregation of the yields is a "government-created value" — *i.e.*, individual yields do not become usefully large until they are aggregated — then the yield for any individual crop cannot any longer be said to be a property interest of the landowner. In other words, the value created by the aggregation of the yields somehow *transforms* what in any other setting would be an indisputable property interest of the landowner, into an interest of the State.

By what principle of property rights or law could that transfer of interests possibly be said to occur? In the instant case,

what can account for Respondents' loss of the State's correlative duty not to interfere with their claim of beneficial use? On this score, the imagery of the Fifth Circuit's opinion below is particularly apt.

It has been suggested that the IOLTA program represents a successful, modern-day attempt at alchemy. While legends abound concerning the ancient, self-professed alchemists who worked tirelessly towards their goal of changing ordinary metal into precious gold, modern society generally scoffs at such attempts to create "something from nothing." The defendants in this case denounce such skepticism, declaring that they have unlocked the magic that eluded the alchemists. . . . The defendants then contend that Texas used the IOLTA program to stake a legitimate claim to these funds and that the plaintiffs cannot now seek to repossess the fruits of the magic as their own. We, however, view the IOLTA interest proceeds not as the fruit of alchemy, but as the fruit of the clients' principal deposits.

Washington Legal Foundation v. Texas Equal Access to Justice Foundation, 94 F.3d 996, 1000 (5th Cir. 1996). *Amici* do, in fact, offer a candidate for the missing explanatory principle. Relying on the Court's analysis in *Penn Central Transp. Co. v. New York City*, 438 U.S. 104 (1978), the United States asserts that Respondents are unable to show that the IOLTA program "deprives them of 'interests that were sufficiently bound up with the reasonable expectations of [respondents] to constitute 'property' for Fifth Amendment purposes.'" Brief of the United States at 13.³

³ *Pennsylvania Coal Co. v. Mahon*, 43 S.Ct. 158 (1922), is the leading case for the proposition that a state statute that substantially furthers important public policies may so frustrate distinct investment-backed

However, *Penn Central's* concept of reasonable "investment-backed" expectations is plainly inapposite in this context. In that case, owners of a city railroad terminal which was designated a historic landmark, could not establish a "taking" simply by showing that they had been denied the ability to exploit the superadjacent air space, irrespective of the remainder of the parcel. The concept of "investment-backed" expectations thus refers to cases where it cannot fairly be said that the disputed use of the property would have been envisaged, or a reasonable expectancy as to a particular gain have been in play, when the property owner decided to acquire the property in the first place.

But it cannot seriously be argued that interest accruing on principal — one of the most fundamental and salient dynamics in force whenever funds are deposited — was not "sufficiently bound up" with Respondents' expectations concerning the possible uses of the funds involved here. Interest as an incident of principal is surely one of the most foreseeable dimensions of modern commercial relations. Indeed, for that reason the instant case seems the very counterfactual to fact patterns such as *Penn Central*, *supra*, where the property owner's expectations were held to be too attenuated. *See also, e.g., United States v. Willow River Power Co.*, 65 S.Ct. 761 (1945) (interest in high-water level of river for runoff of tailwaters to maintain power head is not property); *United States v. Chandler-Dunbar Water Power*

expectations as to amount to a "taking." There the claimant had sold the surface rights to particular parcels of property, but expressly reserved the right to remove the coal underneath. A Pennsylvania statute, enacted after the transactions, prohibited any mining of coal that caused the subsidence of any house, unless the house was the property of the owner of the underlying coal and was more than 150 feet from the improved property of another. Because the statute made it commercially impracticable to mine the coal, the Court held that the statute was invalid as effecting a "taking" without just compensation.

Co., 33 S.Ct. 667 (1913) (no property interest can exist in navigable waters).

If *amici*'s "reasonable expectations" argument were grounded in the fact that Respondents' interest in the yield is of relatively minor size, or that their deposit by itself may create only nominal value, *see* Brief of the United States at 23-24, that too would be an error. The extent of Respondents' property interest is not a function of the value the principal can produce. As demonstrated in Section B, *infra*, that criterion is irrelevant to the existence of Respondents' property rights, as this Court determined in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980) ("The earnings of a fund are incidents of ownership of the fund itself and are property just as the fund is property").

Nor can *amici* persuasively urge that, because the deposit of the funds in the IOLTA account was mandated by law,⁴ then Respondents' property interest could have included no aspect of "reasonable expectations." This reasoning fails in at least two respects. First, the conclusion begs the question. *Amici*'s "reasonable expectations" principle is the critical link in the Created-Value argument. The fact that the IOLTA program legally compelled the funds to be deposited cannot therefore be offered as the justification to sever principal from interest. That would be a tautology: *Amici* would in effect be saying to Respondents, "You retain no property interest in the IOLTA yield because the IOLTA program takes it away from you." A principled basis for "taking it away from you" — for the deprivation of that interest — is precisely what *amici* must offer in support of the IOLTA program, but they cannot.

⁴ In Florida, IOLTA accounts are mandated by state court rule.

Moreover, as a matter of the formal structure of their argument, *amici* cannot press *both* the claim that mandatory IOLTA proves the absence of "reasonable expectations" *and* the claim that Respondents' exclusionary rights were "voluntarily relinquished" when the funds were deposited with the attorney. *See, e.g.*, Brief of ABA at 13-14. Those positions are logically inconsistent, causing the Value-Created argument to collapse on itself.

In short, without a principled basis for demonstrating why the general rule that interest is an incident of principal is defeated by the Value-Created argument, the claim that Respondents' property interest does not extend to the IOLTA-created yield, must fail.

B. The Created-Value Argument Rests On A Faulty Premise.

1. The Created-Value argument is invalid for another reason. To see this, consider the argument's critical premise — namely, that if the aggregate yield on principal is not something attributable to the property-owner's purposive *use* of the principal, then it cannot be said that the yield qualifies as a property interest in which the owner retains any rights. *Amici* claim that Respondents' rights must have preterminated because the process by which the IOLTA-generated yield occurs is one in which Respondents are not involved and cannot control. Hence, the argument concludes, since "nothing is taken from clients," Brief of ABA at 12, the regulatory scheme underlying IOLTA programs cannot, by definition, pose a takings problem.

This premise is erroneous because it mistakenly equates the inability to control or create the process by which the interest is generated, with Respondents' ultimate right to the beneficial use of the property. To see the difference, one can think of

Respondents' funds as a necessary, but not sufficient condition, for the creation of the yield. Respondents' property alone did not produce the yield, but it was plainly a contributing cause in that process, without which the yield would not have materialized. Looked at in this way, it is clear that nothing about the process bore on Respondents' underlying property rights.

This point is crucial because the faulty premise created by *amici*'s conflation of these notions explains their apparent belief that Respondents' right to exclusive use of the property has disappeared or been trumped by the State. To the contrary, the use of an individual's property, whether in an IOLTA program or a different context, cannot affect the property-owner's right of exclusion. The accretion of interest resulting from funds placed in IOLTA accounts is simply a consequence of a particular use of that property. As shown above, the fact that any single individual's principal does not by itself create the yield has no bearing, analytically, on the nature of the property rights in play, including the right of exclusive use.

Over the years, this Court repeatedly has invoked the principle that the right to exclude others from the use of one's property is one of the defining attributes in the "bundle" of property rights. For example, in *Dolan v. City of Tigard*, 114 S.Ct. 2309 (1994), the Court predicated its analysis on the petitioner's "loss of her ability to exclude others" and described the right to exclude others as "one of the most essential sticks in the bundle of rights that are commonly characterized as property." *Id.* at 2316 (citation omitted). See also, *Loretto v. Teleprompter Manhattan CATV Corp.*, 102 S.Ct. 3164, 3176 (1982) ("The power to exclude has traditionally been considered one of the most treasured strands in an owner's bundle of property rights"); *Nollan v. California Coastal Com'n*, 107 S.Ct. 3141, 3145 (1987) ("We have repeatedly held" that the right to exclude others is an essential attribute of property

ownership"); *United States v. General Motors Corp.*, 65 S.Ct. 357 (1945) (The term "property" as used in the Taking Clause includes the entire "group of rights inhering in the citizen's ownership").

In addition, scholarly commentary is remarkably unanimous in endorsing the validity of the exclusive use principle. See, e.g., A.M. Honore, *Ownership*, in OXFORD ESSAYS IN JURISPRUDENCE 107-47 (A.G. Guest ed., 1961); RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 35-104 (1985); LAWRENCE C. BECKER, PROPERTY RIGHTS: PHILOSOPHIC FOUNDATIONS 11-21 (1977); BRUCE A. ACKERMAN, PRIVATE PROPERTY AND THE CONSTITUTION 232 (1977); J.E. Penner, *The "Bundle of Rights" Picture of Property*, 43 U.C.L.A. L. REV. 711, 742 (1996) ("The right to property is the right to determine the use or disposition of an alienable thing in so far as that can be achieved by others excluding themselves from it"); Frank Snare, *The Concept of Property*, 9 AM. PHIL. Q. 200 (1972) (Ownership entails the right of exclusion; "others may use the property if and only if the owner consents").

In short, because a critical premise of *amici*'s argument conflicts with the well-established right to exclude others from the use of one's property, their argument is unavailing.

2. It is important to recognize a vital corollary to what has so far been said. Because the processes affecting the uses of property do not affect ownership rights in it, one's capacity to retain decisionmaking authority as to the disposition of the property remains firmly in place. This is a helpful way to think about Respondents' exclusionary rights as an essential attribute of their general property rights in this case. While this view may seem intuitively obvious, it is a useful vehicle for illustrating in the most concrete way precisely *why* the existence of mandatory

IOLTA should not be allowed to trump the otherwise indisputable connection between principal and interest.

Specifically, with this model in mind it is easy to imagine any number of circumstances where an individual may *object* — in a fully warranted way — to the use of his property to support various legal programs supported by IOLTA-generated revenues. The most clear-cut cases, of course, are those in which the person is ideologically opposed to litigation positions that may be advocated by attorneys who are paid with IOLTA funds, in whole or in part, for the representation of their clients. These attorneys need not even be dealing with the sorts of issues, such as abortion rights, that are the most politically divisive. For instance, a person may be concerned that his position on such matters as immigration policy, parental rights, prisoner rights, welfare reform, drug enforcement laws, and other legal issues are typically at odds with positions regularly taken by advocacy organizations, including legal services providers, who are funded by IOLTA.

In addition to these categories of cases involving philosophical or political differences, are the variety of situations where an individual recognizes that his own economic or legal interests are compromised by the litigation efforts of legal services attorneys; for example, when a landlord attempts to evict non-paying tenants represented by an IOLTA-funded legal services agency, and thus sees his own property — the retainer fee deposit — as contributing to the legal advocacy of the very tenants he is trying to evict.⁵

⁵ Indeed, in Florida IOLTA monies can, and presumably have, been used to fund death penalty appeals, creating the gravely troubling prospect that the interest earned on the trust deposit money of victims' families has paid to defend the person convicted of murdering their loved one.

In these cases, the principle that a person holds exclusionary rights with respect to his property has particular force if viewed in terms of the owner's capacity for exclusive decisionmaking. An unauthorized use of the property that conflicts with his decision as to how he desires the property to be used, is a clear infringement. In our case, the State has usurped Respondents' rights in precisely this manner, and *amici's* Created-Value argument offers no way out of that problem.

CONCLUSION

For these reasons, the judgment of the Fifth Circuit should be affirmed.

Respectfully submitted,

HARVEY M. ALPER
ALPER WALDEN & CRICHTON
112 West Citrus Street
Altamonte Springs, FL 32714
(407) 772-7333

RONALD D. MAINES
(*Counsel of Record*)
R. SHAWN GUNNARSON
MAINES & LOEB, PLLC
2300 M Street, N.W.
Suite 900
Washington, D.C. 20037
(202) 223-2817

Counsel for *Amicus Curiae*

19
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

HON. THOMAS R. PHILLIPS, *et al.*,
Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, *et al.*
Responden's.

On Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

**BRIEF OF
THE TEXAS JUSTICE FOUNDATION
AS AMICUS CURIAE
SUPPORTING RESPONDENTS**

David L. Wilkinson*
17589 Wadell Court
Hamilton, Virginia 20158
(540) 338-9537

Allan E. Parker, Jr.
Texas Justice Foundation
8122 Datapoint Dr., Suite 812
San Antonio, Texas 78229
(210) 614-7157

*Counsel for the Texas Justice
Foundation, amicus curiae*

*Counsel of Record

October 10, 1997

CASILLAS PRESS • 1717 K STREET, NW • WASHINGTON, D.C. 20006 • (202) 223-1220

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INTEREST OF AMICUS CURIAE

The Texas Justice Foundation is a nonprofit corporation that provides free legal representation in cases involving the protection of individual rights and/or cases which seek to limit government to its proper role. It is deeply concerned with the protection of private property rights for individual citizens. It provides significant legal services to low income individuals without charge.

The Texas Justice Foundation since its inception in 1993 has appeared in cases before this Court and the Texas Supreme Court.¹

SUMMARY OF ARGUMENT

The petitioners and all but one of the scores of amici curiae supporting them go out of their way to convince this Court that a decision favoring respondents will have a deleterious effect upon the delivery of legal aid because the interest from IOLTA programs is usually used to help fund legal aid programs. Some of the amici offer funding statistics to attempt to prove to the court how important IOLTA interest is to the attainment of equal access to justice. Yet none of the amici inform the Court that in Texas individual members of the Bar, acting alone or through organized pro bono programs, donate well over one million hours a year to free legal advice and representation of Texas indigents. And none of the statistics offered include in their calculations the value of those hours—which the State Bar of Texas has placed at over one hundred

¹ Statement required by Supreme Court Rule 37.6. This brief has been exclusively authored by the Attorneys for Amicus Curiae whose names appear on the cover of this brief. Neither of them is an attorney for any of the parties to this lawsuit. There was no monetary contribution to the preparation or submission of this brief by any person or entity other than the amicus curiae.

million dollars annually. Nor do they show how small a percentage of the total resources devoted to legal aid comes from interest from IOLTA programs. Of course the petitioners and the *Amicus Curiae* parties who link this case with legal aid realize, as the Ohio parties frankly concede, that:

. . . the point is not strictly germane either to the narrow legal determinations of whether a "property interest" exists or what "just compensation" requires under the peculiar circumstances of IOLTA programs. . .

Amicus Curiae Brief of the Columbus Bar Association, et al. In Support of Petitioners, 20. The point, to paraphrase the Ohio parties, is not germane at all.

However, the petitioners and all *Amici Curiae* except the United States devote substantial space to this non-germane point. The Ohio parties even contend ". . . it is impossible to decide this case entirely in a vacuum that would divorce it from its important practical consequences." See *id.* A group of attorneys general list separately, as one of their arguments, that "The States Have Important Interests in Providing Open Access to the Courts and in the Administration of Justice." *Amicus Curiae* Brief of State Attorneys General In Support of Petitioners, 45 (Aug. 25, 1997). Finally, the American Association of Retired Persons seriously contends that this Court consider and decide other challenges to IOLTA presented by respondents below, but left open and not presented by the petition to this Court, because legal services providers "desperately" need the interest from IOLTA programs *Amicus Brief* of the American Association of Retired Persons, et al., Urging Reversal of the Judgment Below, 15-16

The Texas Justice Foundation does not disagree that, for example, states have an important interest in providing equal

access to justice for all their residents. But it does challenge the common premise of petitioners and their supporting parties that an issue as important as the proper scope of governmental taking without just compensation is somehow secondary in importance to their fears that civil legal aid would be dealt a serious blow if this Court affirms the decision of the Fifth Circuit. And it further challenges the statistics presented as being selective and misleading in purporting to convey the importance of interest generated by IOLTA in Texas and the rest of the country relative to pro bono programs and other public and private funding.

Finally, the Texas Justice Foundation challenges the contention of several *Amicus Curiae* parties that a substantial amount of IOLTA interest is used by state courts for projects to further the administration of justice (apart from providing equal access to justice) because there is not adequate funding for the judiciary. In Texas, not one cent of IOLTA money is used for this purpose and the amounts used therefor in other states is inconsequential.

ARGUMENT

I. THE AMOUNT OF INTEREST GENERATED BY THE TEXAS IOLTA PROGRAM AS A PERCENTAGE OF ALL RESOURCES DEVOTED TO LEGAL AID FOR THE INDIGENT IS ALMOST INSIGNIFICANT.

A. The Conservatively Measured Value of Pro Bono Time Devoted to Civil Legal Aid for the Indigent by Over 67,000 Texas Lawyers Is the Backbone of the Texas Delivery System.

Since 1992, the State Bar of Texas has attempted to ascertain systematically the amount of pro bono time devoted by all its attorney members. Beginning with the 1994-95 bar fiscal year, it has supplied each member attorney with a form, along with a dues statement, for the attorney to use to report voluntarily the number of his or her pro bono hours during the last twelve months. The State Bar has not compiled the figures for the twelve-month reporting period which ended in May, 1997. For the prior two reporting periods, however, 26,185 and 25,728 attorneys, respectively, completed and returned the form along with his or her dues.²

From the responses it received, the State Bar compiled the number of pro bono hours reported during the reporting period. For each of the periods ending May, 1995, and May, 1996, respectively, that number slightly exceeded one million.³ This total number included only the hours actually reported. The State Bar did not attempt to extrapolate the number of hours which were spent by the majority of the State Bar attorney members who did not return a pro bono reporting form. Obviously many additional hours over and above the one million

² DEPARTMENT OF RESEARCH AND ANALYSIS, STATE BAR OF TEXAS, PRO BONO REPORTING, JUNE 1995 THROUGH MAY 1996, Page 3 (1996).

³ *Id.*

hours reported each year were donated but not reported.

The State Bar has not placed a dollar value per hour in its Pro Bono Reporting compilations since 1992 but it did place a value of \$140 per hour in its report for 1992.⁴ More recently, the President of the State Bar suggested a value of \$100 per hour.⁵ One hundred dollars is also the assigned value of each hour of attorney pro bono work in the 1992 study by Justice Howard Dana of the Maine Supreme Court, relied upon by the American Bar Association ("ABA") *Amicus Curiae* Brief of American Bar Association In Support of Petitioners, 2 (Aug. 25, 1997). Using that figure, the value of attorney pro bono time for legal aid for the indigent in Texas exceeds \$100,000,000 annually.

That the State Bar of Texas annually compiles pro bono data which then becomes available to the public is a well known fact to over 67,000 Texas lawyers who receive each year a dues statement and pro bono reporting form. It is certainly known to the petitioners who nevertheless state confidently that "The American IOLTA concept . . . has become the backbone of pro bono programs throughout the United States." Brief for Petitioners, 3 (Aug. 25, 1997).

The above data clearly demonstrates that Texas lawyers who provide each year well over \$100,000,000 in donated time are the backbone of legal aid programs and delivery in Texas, not Texas' IOLTA program which this year generated only \$4,500,000.⁶

⁴ STATE BAR OF TEXAS, 1992 ANNUAL PRO BONO REPORTING RESULTS 2 (1993).

⁵ *State Bar of Texas President Responds to ABC TV Program*, SOUTHWEST NEWSWIRE, Jan. 9, 1996, at 3, available in LEXIS, News Library, Curnws File.

⁶ *Restrictions Considered For IOLTA Grant Recipients*, TEXAS LAWYER, September 1, 1997, at 1, available in LEXIS, News Library, Curnws File.

B. Legal Aid Grants Made Possible by Interest Generated by Texas' IOLTA Program Have Decreased in Amount Between 1992 and 1997.

In Texas, unlike many other states, all of the interest earned by IOLTA has been used to support legal aid. The amount of all legal aid grants made by petitioner Texas Equal Access to Justice Foundation (TEAJ) each year to Texas legal aid providers has steadily declined from 1992 to the present. The total amount granted each year, which comes from interest yielded by IOLTA, is set forth below for the period in question. The grant year for TEAJ is from July 1 to June 30:⁷

Grant Year Ending	Total Grants
1993	\$9,360,000
1994	7,190,000
1995	5,729,000
1996	5,199,000
1997	5,264,000
1998	4,906,000

Beginning in the '90s, interest from IOLTA has been the third largest source of support for legal aid in Texas, behind only pro bono hours and funding from the federal Legal Services Corporation ("LSC"). However, the Texas Legislature enacted during its past session Senate Bill 1534 which made available additional court filing fees to provide basic civil legal services to the indigent. The legislation, which became effective September 1, 1997, is estimated to generate as much as \$5 million annually.⁸ If that occurs, state filing fee monies could

⁷ TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION, SUMMARY LISTS OF RECIPIENTS BY ORGANIZATION NAME, AMOUNT GRANTED AND GRANT PURPOSE, May 22, 1996; May 19, 1994; 1993; 1992; 1997-1998 Grantees (Revised by Board on 6/6/97); *Legal Aid Cuts Magnify IOLTA Woes*, TEXAS LAWYER, August 14, 1995, at 5, available in LEXIS, News Library, Curnews File.

⁸ *Filing Fee Bill*, TEXAS LAWYER, October 14, 1996, at 1, available in LEXIS, News Library, Curnews File.

surpass interest from IOLTA as the third greatest support source in the state.

C. Interest from IOLTA in Texas Now Constitutes Only Three Percent of All Resources Devoted to Legal Aid.

The last year for which funding data for Texas legal aid efforts is available is 1994. And even that data includes only the total funding of the legal aid providers which received grants from the LSC.⁹ That funding, combined with the value of all the pro bono efforts of only those Texas lawyers who voluntarily reported their hours, totalled \$124,718,000.¹⁰ Interest from IOLTA included in that amount was \$4,163,000.¹¹

The total funding of all LSC grantees for calendar year 1994 combined with the value of reported pro bono in that period is as follows:

Value of Reported Pro Bono	LSC Grantee Funding And Pro Bono Value	LSC Grantee IOLTA
\$86,946,000	\$124,717,000	\$4,163,000

⁹ The Dana study, referred to in the *Amicus Curiae* Brief of the ABA, *supra*, at 2, also included only the total funding of legal aid providers in Texas who received grants from the LSC, presumably because information as to the total funding of all providers in Texas, including those who received no LSC grant, was unavailable. That is the reason why only the total funding of LSC grantees in Texas for 1994 is presented. The Dana study, entitled "1991 Funding For Civil Legal Services of the Poor," is a ten page report dated Nov. 29, 1992, and can be obtained from the ABA.

¹⁰ The value of the reported pro bono hours for 1995 was calculated by adding half of the hours reported for the twelve month reporting period ended May, 1995, to half of the hours reported for the twelve month reporting period ended May, 1996, and multiplying the sum by \$100.

¹¹ This amount differs from both the total amount of grants for the grant year ended 1994 and the total amount of grants for the grant year ended 1995 because this amount only includes IOLTA grants received by LSC grantees.

The percentage of all funding which came from IOLTA interest was only 3.3%. (\$4,162,000 divided by \$124,717,000).

II. PETITIONERS ASSUMPTION THAT AN ADVERSE DECISION WILL TERMINATE ALL IOLTA PROGRAMS IS UNFOUNDED, BUT IN ANY EVENT THE AMOUNT OF INTEREST GENERATED BY ALL IOLTA PROGRAMS AS A PERCENTAGE OF ALL RESOURCES DEVOTED TO LEGAL AID FOR THE INDIGENT IS QUITE SMALL.

Petitioners and their supporting parties seem to assume that if the Texas IOLTA program is struck down, then *ipso facto* all other 49 viable IOLTA programs in the nation are invalid. However, if this Court affirms the Fifth Circuit holding, it is not at all certain that a significant portion of IOLTA interest will be permanently lost to the states. It is well known — and documented in the briefs — that some of the states adopted their programs through legislative action. *See e.g., Amicus Curiae* Brief of the Council of State Governments, *et al.* Supporting Petitioners, 3 (Aug. 25, 1997). The taxing power of state legislatures presents new and very different legal considerations from those before this Court. If this Court affirms the Fifth Circuit's decision, it is quite conceivable that many more state legislatures will step forward and legislatively clone their states' IOLTA programs. It is just as conceivable that other state legislatures will reimplement IOLTA programs after having made significant changes in them, such as attaching conditions to the kinds of cases which legal aid providers may bring using IOLTA grant money, or providing that a specified portion of the monies should go to legal aid providers which follow a pro bono model of delivery rather than the staff model. In sum, it just cannot be assumed that a decision on the merits of the case before this Court favorable to respondents will result in the permanent or even temporary dismantling of 50 IOLTA programs nationwide.

But assuming that such a decision would result in the termination of many or even most IOLTA programs, the diminution of resources spent to support civil legal aid would be minimal. The amount of interest generated by all IOLTA programs quoted by petitioners and many supporting parties is \$100,000,000 annually. *See e.g.,* Brief for the Petitioners, *supra*. Accepting that figure as correct, it represents less than a few percent of the total resources devoted to civil legal services in all the states, as the following shows:

The greatest single source of legal aid support nationally, as well as in Texas, is the millions of hours of pro bono provided annually by hundreds of thousands of lawyers and valued in the billions of dollars. State and city bar surveys taken since 1990 confirm these amounts. A 1991 California study determined that 68,000 lawyers in that state performed pro bono 5.7 million hours, valued by California state bar officials at \$850,000,000.¹² A 1992 study in New York showed that 48,000 attorneys there devoted 2,100,000 hours for pro bono legal aid, valued at \$210,000,000.¹³ Surveys taken in 1995 in Florida, Kentucky, New Mexico, Oregon, and Philadelphia, as well as Texas, taken together account for another 3,000,000 hours, valued at \$280,000,000.¹⁴ The lawyers in the bar associations

¹² Office of Legal Services of The State Bar of California, Making Equal Access to Justice a Reality: A Report on the Status of Pro Bono Legal Services in California, 72-73 (Nov. 1991).

¹³ VICTOR MARRERO AND JUSTIN L. VIGDOR, CO-CHAIR, FINAL REPORT OF THE PRO BONO REVIEW COMMITTEE 16 (Apr. 18, 1994).

¹⁴ STANDING COMMITTEE ON PRO BONO SERVICES, REPORT TO THE SUPREME COURT OF FLORIDA, THE FLORIDA BAR, AND THE FLORIDA BAR FOUNDATION 1 (1995); FLORIDA BAR JOURNAL, Dec., 1995, 30; Lynnette M. McFaul, *Lawyers Report Over 72 Thousand Pro Bono Hours*, KENTUCKY BAR NEWS, Spring, 1996, at 14; *Pro Bono Honor Roll*, BAR BULLETIN (New Mexico) Vol. 35, No. 35, Sept. 5, 1996, at 10; OREGON STATE BAR, 1994 ECONOMIC SURVEY 30 (Mar. 1, 1995); SAMUEL H. BECKER, CO-CHAIR, LONG RANGE PLANNING COMMITTEE, A LONG RANGE PLANNING REPORT: 1995 SURVEY OF LAWYERS, TABLES 068-069 (Oct. 29, 1995).

of these seven states and Philadelphia constitute 40% of all lawyers in the country.¹⁵ Assuming that these lawyers are representative of the total lawyer population, the annual worth of pro bono work done annually is over \$3.3 billion.¹⁶

In addition to IOLTA funding, legal aid providers receive cash funding from the Legal Services Corporation of over \$250,000,000 annually, plus a total of at least two hundred million dollars from state filing fees and general state legislative appropriations; county and city contributions; federal funding from agencies other than the LSC; and funding from bar associations and foundations, the United Way, and other private sector individuals and entities.¹⁷

The total value, then, of all resources committed to delivering civil legal aid to the indigent in the country is at least \$3.8 billion of which IOLTA's \$100 million is less than 3%.

III. AMOUNTS DERIVED FROM IOLTA INTEREST AND EXPENDED ON PROJECTS TO FURTHER THE ADMINISTRATION OF JUSTICE, APART FROM PROVIDING CIVIL LEGAL AID, ARE *DE MINIMIS* NATIONALLY: IN TEXAS, ALL IOLTA INTEREST GOES FOR LEGAL AID.

The state attorneys general parties state that, quite apart from providing open access to the courts, their states have important interests in the administration of justice; and note that IOLTA monies are spent on such projects of their bar associations as alternative dispute resolution programs,

¹⁵ Barbara A. Curran and Clara N. Carson, American Bar Foundation, *The Lawyer Statistical Report: The U.S. Legal Profession in the 1990s*, 235 (1994)

¹⁶ The sum of \$850 million, \$210 million and \$280 million is \$1.34 billion. This amount is to 40% as \$3.5 billion is to 100% (1.34 divided by .4 equals 3.35).

¹⁷ LEGAL SERVICE CORPORATION, 1995 ANNUAL REPORT 9 (1996)

victims services programs, minority law recruitment, programs, and law school scholarship programs. *Amicus Curiae* Brief of the State Attorneys General In Support of the Petitioners, *supra*, at 2-5.

In Texas, all IOLTA grants go to civil legal aid providers. (See footnote 7) (The Texas Attorney General did not join the brief of the other state attorneys general, although the office of the Texas Attorney General is representing the Texas Supreme Court petitioners herein, as is its duty.) Nationwide, the amount of IOLTA monies going for these non-legal aid projects is concededly only a few million dollars.¹⁸

CONCLUSION

This Court should decide the case before it on its own merits, quite divorced from whatever consequences its decision might be said to have on legal aid delivery systems in Texas and other states.

The enactment in Texas of recent legislation to provide at least several million dollars of new money for the provision of legal aid shows that legislatures are not unaware of the needs of the poor for adequate and appropriate legal assistance. The Texas bill, which contains conditions on how this money should be spent, stands in sharp contrast to the position of a legal aid provider *amicus* party that IOLTA monies are "desperately" needed to "replace the . . . restrictions placed on the use of those public funds [sic]." *Amicus Curiae* Brief of the American Association of Retired Persons, *supra*, at 16. The Texas Justice Foundation suggests that the Texas approach is much to be preferred to a system of court-implemented funding mechanisms which lead legal aid providers to believe there are no limits on how the monies can be used.

¹⁸ *Amicus Curiae* Brief of the Council of State Governments Supporting Petitioners, *supra*, at 4.

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

David L. Wilkinson*
17589 Wadell Court
Hamilton, Virginia 20158
(540) 338-9537

Allan E. Parker
Texas Justice Foundation
8122 Datapoint Dr., Suite 906
San Antonio, Texas 78229
(210) 614-7157

*Counsel for the Texas Justice
Foundation, amicus curiae*

*Counsel of Record

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On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF OF THE ASSOCIATION FOR
OBJECTIVE LAW AS AMICUS CURIAE
SUPPORTING RESPONDENTS

STEPHEN PLAFKER
1538 Marion Drive
Glendale, CA 91205-3721
(818) 956-3288
Attorney for Amicus Curiae

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INTEREST OF AMICUS CURIAE¹

THE ASSOCIATION FOR OBJECTIVE LAW (TAFOL) is a Missouri non-profit corporation whose purpose is to advance Objectivism, the philosophy of Ayn Rand, as the basis of a proper legal system. TAFOL's supporters are lawyers, law students and others, some residing in Texas, who subscribe to Ayn Rand's philosophy and who would suffer harm should this Court reverse the decision of the court below. The non-lawyers are clients and potential clients of lawyers. In the ordinary course of events, their lawyers would hold some of their money in a trust account. Under IOLTA, the proceeds of this money would be used for programs which work against their self-interest. The lawyer supporters would be conscripted to assist in what amounts to theft of their clients' property.

SUMMARY OF ARGUMENT

TAFOL's opposition to the IOLTA program is based on Ayn Rand's political principles which are, of necessity,

¹ All parties to the within action have consented to the filing of the brief, and letters containing these consents have been filed with the Clerk of this Court.

No counsel for any party to the within action has authored this brief in whole or in part. Respondent, Michael J. Mazzone, is president of amicus curiae, The Association for Objective Law; he provided criticism and editorial comments of drafts of the brief. The Association for Objective Law has borne all costs of preparation and submission of this brief; there have been no monetary contributions in connection with the preparation of this brief from any party to this case or from any other person or entity.

based on her metaphysics, epistemology and ethics. The basis of her ethical theory is rational self-interest. Its economic-political consequence is laissez-faire capitalism. Each individual has the absolute right to his own life. This necessitates control over his property without interference so long as he does not violate anyone else's rights. The sole function of government is to protect all rights, especially the right of property.

The IOLTA program is based on the opposite moral premise: that man is obligated to serve others. The political consequence of this premise is that one may be forced to support others. Many, if not most, of the suits supported by IOLTA money are directed at enforcement of what are euphemistically called "entitlements," i.e., forcing those who have money to support those who do not, IOLTA is a program that violates rights; it is a reversal of the proper function of government.

It will be shown by quotations from English and American intellectual leaders throughout the years that the American system of government is implicitly based on Objectivist principles. Because the IOLTA program conflicts with these principles, it cannot be upheld.

ARGUMENT

A. Summary of the Texas IOLTA Program

William R. Summers is a businessman who regularly hires lawyers to represent him. As a condition of their representation, these lawyers require him to advance retainer fees which are held in trust accounts. In addition to retainer fees, these accounts typically contain clients'

money held for investment purposes and money held pending distribution.

The law at issue in this case requires that the money in these accounts be made available to earn interest to provide legal services to low-income persons. Typical of the uses of the money are suits

to secure entitlement to benefits such as, but not limited to, social security, aid to families with dependent children, food stamps, special education for the handicapped, Medicare, Medicaid, subsidized or public housing, or other economic, shelter or medical benefits provided directly to indigent individuals.

Rules Governing the Operation of the Texas Equal Access to Justice Program, Rule 15, J.A. 118-119.

No one ever asked Mr. Summers whether he wanted his money to be used to generate income to support these suits. When he complained, he found the chief justice of every state in the country declaring his claim of ownership a "fantasy," sneering at his money as "paltry," referring to him as "silly."² His lawyers were not given the freedom to determine how their accounts were to be used, nor whether they were willing to keep records for the benefit of the favored. Nor were the bankers asked whether giving the interest, and keeping the records, is economical.

The IOLTA program thus takes proceeds of the efforts of Mr. Summers, and of others in positions similar to him. It conscripts the efforts and resources of lawyers

² Brief of Conference of Chief Justices 8, 12.

and banks, making them aiders and abettors in the confiscation of their clients' money.

B. The Importance of Property Rights

The *fundamental* problem with the IOLTA program is its ethical premise: that man has an obligation to serve others. The political consequence of this premise is that the state of Texas may declare that, unless Mr. Summers chooses to forego effective legal representation, he must put his funds at the disposal of the state. His own concerns are unimportant.

The alternative moral basis is the ethics of rational self-interest. Each individual has a moral right to his own life. He decides how he is to expend his efforts and how the results of these efforts are to be used. The political consequence of this ethical theory is a limited government whose sole function is to secure liberty. The right to property is central to the implementation of this function. To the extent a man is forced to let someone else use his belongings, he is not free.

Consider the following examples:³

- The prohibition of an established religion is essentially a rule that the state may not take one's property to support religion. *Grand Rapids School District v. Ball*, 473 U.S. 373, 385, 392 (1985); *Everson v. Board of Education*,

³ The cases in the following list are cited, not as authority, but as illustrations of the statements with which they are associated.

330 U.S. 1, 11-12, 16 (1947); *Virginia Statute of Religious Liberty* (1786), Henry Steele Commager, *Documents of American History to 1898* (1963) 125.

- The free exercise of religion requires the ability to construct and control buildings and to profit from business relationships. *Pierce v. Society of Sisters*, 268 U.S. 510, 532, 534, 535 (1925).
- Without complete control over property, every businessman serving the public can be, and many are, forced to support views to which he is opposed, despite the rule of *West Virginia State Board of Education v. Barnette*, 319 U.S. 624 (1943), *Wooley v. Maynard*, 430 U.S. 705 (1977), and *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241 (1974). *PruneYard Shopping Center v. Robins*, 447 U.S. 74, 85 et seq. (1980).
- Freedom of the press requires control over printing presses, buildings to house them, newsprint, trucks, and money (*Grosjean v. American Press Co.*, 297 U.S. 233 (1936)) as well as confidence that the proceeds of the sales of newspapers will not be taken because of disagreements with what is published (*New York Times Co. v. Sullivan*, 376 U.S. 254 (1964)).
- No one can sit alone in his own house and peacefully read pornography without the ability to lock the doors against those who disapprove. *Stanley v. Georgia*, 394 U.S. 557 (1969).
- The protection of the "intimate relation of husband and wife and their physician's role

in one aspect of that relation" (*Griswold v. Connecticut*, 381 U.S. 479, 482 (1965)) concerns nothing more than the ability to exchange money for physical items.

- To travel from place to place, one must have control over an automobile and money to buy gasoline, to maintain the automobile, and to buy food and shelter on the way. *Edwards v. California*, 314 U.S. 160 (1941).

Each of these examples illustrate the fact that control over physical objects – the right to exclude others from one's property – is the essence of property rights. In each case, this Court was asked to protect an intellectual or abstract right. (Sometimes the request was successful, sometimes not.) In fact, each of these claims was a demand for undisturbed control over property. This control is necessary for the free exercise of any human activity:

Just as man can't exist without his body, so no rights can exist without the right to translate one's rights into reality – to think, to work and to keep the results – which means: the right of property. . . . Only a ghost can exist without material property; only a slave can work with no right to the product of his effort. . . .

The source of property rights is the law of causality. All property and all forms of wealth are produced by man's mind and labor. As you cannot have effects without causes, so you cannot have wealth without its source: without intelligence.

Ayn Rand, *Atlas Shrugged* (1985) 1062.

The right of property is one of the foundations of the United States. Its importance was stated by the nation's intellectual grandfather:

The great and chief end, therefore, of men's uniting into commonwealths and putting themselves under government is the preservation of their property.

John Locke, *The Second Treatise of Government* (1952) 71 (§ 124).

Its importance is reflected in the common law:

So great moreover is the regard of the law for private property, that it will not authorize the least violation of it; no, not even for the good of the whole community. If a new road, for instance, were to be made through the grounds of a private person, it might perhaps be extensively beneficial to the public; but the law permits no man, or set of men, to do this without consent of the owner of the land. In vain may it be urged, that the good of the individual ought to yield to that of the community; for it would be dangerous to allow any private man, or even any public tribunal, to be the judge of this common good, and to decide whether it be expedient or no. Besides, the public good is in nothing more essentially interested, than in the protection of every individual's private rights, as modelled by the municipal law.

1 William Blackstone, *Commentaries on the Laws of England* (1979) *135.⁴

⁴ Blackstone continues with the observation that the state does condemn property. "[A]nd even this is an exertion of

Its importance was understood by the Founding Fathers:

[T]he original meaning of the word *republic* could be no other than a government in which the property of the people predominated and governed; and it had more relation to property than liberty. It signified a government, in which the property of the public, or people, and of every one of them, was secured and protected by law. This idea, indeed, implied liberty; because property cannot be secure unless the man be at liberty to acquire, use, or part with it, at his discretion, and unless he have his personal liberty of life and limb, motion and rest, for that purpose.

John Adams, *Defence of the Constitutions of Government of the United States* in 5 Charles Francis Adams (ed.), *The Works of John Adams, Second President of the United States* (1851) 454.

Its importance was understood by early courts:

The Court made a few observations on our constitution and system of government. . . .

That by the constitution every citizen had undoubtedly a right to a decision of his property by a trial by jury. For that if the Legislature could take away this right and require him to stand condemned in his property without a trial, it might with as much authority require his life to be taken away without a trial by jury, and that he should stand condemned to die, without the formality of any trial at all: that if the members of the General Assembly could do this, they

power, which the legislature indulges with caution, and which nothing but the legislature can perform."

might with equal authority, not only render themselves the Legislators of the State for life, without any further election of the people, but from thence transmit the dignity and authority of legislation down to their heirs male forever.

Bayard v. Singleton, 1 Martin 42, 45 (N.C. 1797).

Its importance was stated in early treatises:

[Protection of private property] is founded on natural equity, and is laid down by jurists as a principle of universal law. Indeed, in a free government, almost all other rights would become utterly worthless, if the government possessed an uncontrollable power over the private fortune of every citizen. One of the fundamental objects of every good government must be the due administration of justice; and how vain it would be to speak of such an administration, when all property is subject to the will or caprice of the legislature, and the rulers.

3 Joseph Story, *Story's Commentaries on the Constitution of the United States* (1833) § 1784 (footnotes omitted).

Its importance was understood by presidents: "[The principle of slavery] says you work, you toil, you earn bread, and I will eat it." Abraham Lincoln in the last Lincoln Douglas Debate, October 15, 1858, Harold Holzer (ed.) *The Lincoln-Douglas Debates* (1993) 359.

Its importance has been stated in a single sentence: "Without property rights, no other rights are possible." Ayn Rand, "Man's Rights" in *The Virtue of Selfishness* (1964) 94.

The IOLTA program is inconsistent with support for property rights. Its defenders claim that it creates interest

without disturbing principal. But it is exclusive control over principal that makes interest possible. One makes interest by agreeing to relinquish, for a period of time, the right to prevent others from using his money. This is the reason that interest follows principal.

This point is revealed in Petitioners' use of a speech from the movie, *It's a Wonderful Life*.⁵ The ideal of this movie is embodied in the character of Peter Bailey, a man who owns a small town savings and loan association which he operates by lending to those in need. His life consists of sacrificing himself and his family for the benefit of his neighbors. When he dies, his son, George, continues in his footsteps.

George Bailey is the hero of the movie. As a young man, he has passionate ambitions to leave the town in which he grew up, to attend college, and to design buildings and cities. Step by step, he sacrifices his ambitions to keep the savings and loan in business so that it can continue to lend to his neighbors.

This movie views self-interest as evil. It is opposed to intelligence, common sense, ambitiousness, and success. The only successful, wealthy character is a banker who is portrayed as incredibly mean, nasty, dishonest, miserable, and totally lacking in ethical principles.

⁵ "You're thinking of this place all wrong, as if I had the money back in the safe. The money's not here. Well, your money's in Joe's house - that's right next to yours - and in the Kennedy house, and Mrs. MacLain's house, and a hundred others." Petitioner's Brief at 30.

The scene summarized by Petitioners involves George Bailey's last sacrifice. He is just about to leave town for his honeymoon when he is interrupted with news that there is a run on his savings and loan. His neighbors, in a panic, are threatening to withdraw their money. The speech quoted by Petitioners is the beginning of his attempt to dissuade them. At first, it appears that he will fail, but he succeeds with the use of eloquence and by lending to the depositors the money he had saved for his honeymoon.

The IOLTA program shares this movie's ethical premises. Those who have wealth are expected to sacrifice for the benefit of those who do not. The IOLTA program, however then adds the inevitable political consequence of the ethical principle: force. Whereas George Bailey had to persuade his depositors to put their money to charitable uses, those running the IOLTA program use the power of the state. The movie's speech as delivered by one running the IOLTA program would read:

You're thinking of this program all wrong, as if you have a right to the control of your money. Mr. Landlord, you have no choice, you must support your tenants' suits against you. Mr. Taxpayer, you have to support lawyers' bringing suits to force you to pay more for welfare. Mr. Voter, I know you're opposed to racial quotas; that doesn't matter, you have no choice; your money will go to organizations devoted to overturning your vote in the courts. Mr. Employer, don't you dare tell us we can't force you to support the suit that prevents you from firing the incompetent employee - the employee whose actions will subject you to a million dollar harassment suit.

These ethical principles are behind every governmental program that takes from those who have and gives to those who do not. As a result of their acceptance, limitations on the powers of American state and federal governments have all but disappeared. Nothing now prevents any American government from taking property for any purpose. It may take real property to improve the beauty of its neighborhood: *Berman v. Parker*, 348 U.S. 26 (1954); *Note, Constitutional Law – Use of the Police Power for the Attainment of Aesthetic Considerations*, 33 N.Car. L. Rev. 482, 484 (1955). It may take tobacco products for use by soldiers: *Liggett & Myers Tobacco Company v. United States*, 274 U.S. 215 (1927). It may take a sports team on grounds that its citizens want to watch football: *City of Oakland v. Oakland Raiders*, 32 Cal.3d 60, 183 Cal.Rptr. 673, 646 P.2d 835 (1982). It may take property on grounds that the owner has more than the envious deem appropriate: *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984). It may make someone's legally produced property suddenly worthless: *Andrus v. Allard*, 444 U.S. 51 (1979).

In the instant case, this Court can take the first step in restoring the government's proper function. To do so, one begins by examining the nature of man in civilized society:

The basic *social* principle of the Objectivist ethics is that just as life is an end in itself, so every living human being is an end in himself, not the means to the ends or the welfare of others – and, therefore, that man must live for his own sake, neither sacrificing himself to others nor sacrificing others to himself * * *

Can man derive any personal benefit from living in a human society. Yes – if it is a *human* society. * * * The basic political principle of the Objectivist ethics is: no man may *initiate* the use of physical force against others. No man – or group or society or government – has the right to assume the role of a criminal and initiate the use of physical compulsion against any man. Men have the right to use physical force *only* in retaliation and only against those who initiate its use.

Ayn Rand, "The Objectivist Ethics" in *The Virtue of Selfishness* (1964) 27, 32-33.

Proper governments exist to prevent the initiation of force and to control its retaliatory use.

The only proper purpose of a government is to protect man's rights, which means: to protect him from physical violence. A proper government is only a policeman, acting as an agent of man's self-defense, and, as such, may resort to force *only* against those who *start* the use of force. The only proper functions of government are: the police, to protect you from criminals; the army, to protect you from foreign invaders; and the courts, to protect your property and contracts from breach or fraud by others, to settle disputes by rational rules, according to *objective* law.

Ayn Rand, *Atlas Shrugged* (1985) 1062-3.

In the words of the Declaration of Independence, "to secure these rights, Governments are instituted among men."

The IOLTA program is an example of government acting against its essential purpose, initiating force rather than preventing it. Mr. Summers, and those like him, are forced to use their property for purposes which they do not support.

But a government that *initiates* the employment of force against men who had forced no one, the employment of armed compulsion against disarmed victims, is a nightmare infernal machine designed to annihilate morality: such a government reverses its only moral purpose and switches from the role of protector to the role of man's deadliest enemy, from the role of policeman to the role of a criminal vested with the right to the wielding of violence against victims deprived of the right of self-defense.

Ayn Rand, *Atlas Shrugged* (1985) 1063.

In the past, this Court disapproved of depredations of the government upon property:

To lay with one hand the power of the government on the property of the citizen, and with the other to bestow it upon favored individuals to aid private enterprises and build up private fortunes, is none the less a robbery because it is done under the forms of law and is called taxation.

Citizens' Savings & Loan Association v. Topeka, 20 Wall. (87 U.S.) 655, 664 (1874). The Court should return to this approach.

CONCLUSION

For the reasons stated above, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

STEPHEN PLAFKER
1538 Marion Drive
Glendale, CA 91205-3721
(818) 956-3288

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In The
Supreme Court of the United States
October Term, 1997

HON. THOMAS R. PHILLIPS, *et al.*,
Petitioners,
v.

WASHINGTON LEGAL FOUNDATION, *et al.*,
Respondents.

On Writ Of Certiorari To The
United States Court Of Appeals
For The Fifth Circuit

**AMICUS CURIAE BRIEF OF
MOUNTAIN STATES LEGAL FOUNDATION
IN SUPPORT OF RESPONDENTS**

BOBAC A. BARJESTEH
WILLIAM PERRY PENDLEY*
**Counsel of Record*
MOUNTAIN STATES LEGAL FOUNDATION
707 Seventeenth Street, Suite 3030
Denver, Colorado 80202
(303) 292-2021
Attorneys for Amicus Curiae

28 PP

QUESTION PRESENTED

Whether interest earned on IOLTA accounts is a compensable property interest of the client for purposes of a Taking Clause analysis?

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**AMICUS CURIAE BRIEF OF
MOUNTAIN STATES LEGAL FOUNDATION
IN SUPPORT OF RESPONDENTS**

Mountain States Legal Foundation respectfully submits this *amicus curiae* brief on behalf of itself and its members in support of Respondents, Washington Legal Foundation, *et al.* Pursuant to Supreme Court Rule 37.2, this *amicus curiae* brief is filed with written consent of all the parties.¹

—◆—

IDENTITY AND INTEREST OF AMICUS CURIAE

Mountain States Legal Foundation ("MSLF") is a non-profit, membership, public interest, legal foundation organized under the laws of the State of Colorado. MSLF is dedicated to bringing before the courts those issues vital to the defense and preservation of individual liberty, the right to own and use property, limited government, and the free enterprise system. MSLF's members include businesses and individuals throughout the country who own and use land, including members who are clients and have money in IOLTA accounts.

MSLF's interest in the outcome of this lawsuit is tied directly to its members' private property rights. MSLF believes that overturning the Court of Appeals for the

¹ Copies of the consent letters were concurrently filed with the Clerk of Court. In compliance with Rule 37.6 of this Court, *amicus curiae* state that no counsel for any party authored this brief in whole or in part, and that no person or entity, other than *amicus curiae's* members, made a monetary contribution to the preparation or submission of the brief.

Fifth Circuit would do violence to the decisions of this Court that recognize the constitutional vitality of private property rights.

**OPINIONS BELOW, JURISDICTION,
AND STATEMENT OF THE CASE**

MSLF hereby adopts Respondents' description of the opinions below, statement of jurisdiction, and statement of the case.

SUMMARY OF ARGUMENT

Respondents (hereinafter, Summers) have a property interest in the earnings generated through the Texas Interest on Lawyer's Trust Account (IOLTA) program. Summers is the owner of the principal deposited in the IOLTA account. As the owner of the principal he is entitled to its earnings as the fruit of the fund's use. Texas may not appropriate Summers' interest until it exceeds a certain value. Practical problems concerning allocating portions of the interest to clients do not eliminate Summers' property rights in controlling the use of his principal and the interest therefrom.

ARGUMENT

I. INTEREST GENERATED THROUGH THE TEXAS IOLTA PROGRAM IS SUMMERS' PRIVATE PROPERTY AND CANNOT BE TAKEN WITHOUT PAYMENT OF JUST COMPENSATION.

Property is one of the "3 key words" in the Taking Clause. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 142 (1978). The definition of property developed in taking decisions involves a two-tiered analysis. See *Memphis Light, Gas & Water Div. v. Craft*, 436 U.S. 1, 9 (1978); *Bishop v. Wood*, 426 U.S. 341, 344 (1976); *Perry v. Sindermann*, 408 U.S. 593, 602 (1972); *Board of Regents v. Roth*, 408 U.S. 564, 577 (1971). The first step is to determine whether an "underlying substantive interest is created by 'an independent source such as state law. . . .'" *Id.* The second step is to determine whether that interest rises to the level of a 'legitimate claim of entitlement'. . . . " *Craft*, 436 U.S. at 9. The interest earned on IOLTA accounts meets both of these tests.

A. Income Is Client's Property Under Texas Law.

The constitutional "hallmark of property . . . is an individual entitlement grounded in state law, which cannot be removed except 'for cause.'" *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 430 (1982). State judicial and statutory law creates and defines property through "existing rules and understandings." *Roth*, 408 U.S. at 577. An analysis of Texas property law demonstrates that Summers unequivocally has a "legitimate claim of entitlement" in the income generated through his IOLTA account.

At this level, Petitioners, Texas Equal Access to Justice Foundation, and Petitioners' Amici (hereinafter, TEAJF) contend that clients cannot have a cognizable property interest in fund proceeds that, but for the IOLTA program, would never have been generated. TEAJF's argument that property does not exist currently, however, does not address the issue presented in this case. The Texas IOLTA program undoubtedly generates interest property that is allocated to TEAJF for the benefit of political organizations. Since interest property is created, the proper issue for this Court's determination is who owns that property? See Baker & Wood, "Taking": A Constitutional Look At The State Bar Of Texas Proposal To Collect Interest On Attorney-Client Trust Accounts, 14 Tex.Tech.L.Rev. 327, 357 (1983).

Therefore, the first fallacy in TEAJF's argument is that the Texas IOLTA program does not create the right to earn income, as TEAJF would urge; it merely takes income already earned and allocates that income to political organizations. *Id.* Once the interest is created, however, that interest belongs to the owner of the principal. The interest earned on IOLTA accounts, therefore, belongs to Summers, not to TEAJF. It remains undisputed that the IOLTA funds themselves are the property of clients such as Summers. See *Coudert v. United States*, 175 U.S. 178 (1899); *Branch v. United States*, 100 U.S. 673 (1880). And, in Texas the fund owner has a constitutional right to the income generated by that fund. See *Sellers v. Harris County*, 483 S.W.2d 242, 243 (Tex. 1972); *City of Austin v. Austin National Bank*, 503 S.W. 759, 761 (Tex. 1974). "[I]nterest, according to all the authorities, is an accretion to the principal fund earning it, and, unless

lawfully separated therefrom, becomes a part thereof." *Lawson v. Baker*, 220 S.W. 260, 272 (Tex.Civ.App. 1920).

Texas common law specifies that interest is a civil fruit. *United States v. Dresser Indus., Inc.*, 324 F.2d 56 (5th Cir. 1963); *Himely v. Rose*, 9 U.S. 31, 17 (1809). As a civil fruit, "interest follows principal," so that interest earned on a deposit of principal belongs to the owner of the principal. *Sellers*, 483 S.W.2d at 243. The very essence of property is the right to the income generated therefrom.²

Legislative enactments in Texas also recognize that interest is the property of the owner of the principal. Basic trust principles establish that the client is the beneficiary of the trust created by the attorney-trustee. See, e.g., Tex.Prob.Code Ann. § 239 (West 1956) (income to be paid to owner of assets); see also, *Wignall v. Fletcher*, 303 N.Y. 435, 103 N.E.2d 728 (1952). In fact, the beneficiary has an automatic right to income earned without the need for any agreement to that affect. *Id.*

Texas law defines interest as "the compensation allowed by law for the use or forbearance or detention of money." Tex.Rev.Civ.Stat.Ann. art. 5069 § 1.01 (West 1987). Prior to the IOLTA program, Texas attorneys were not required to invest client trust funds to benefit clients. See Tex. Bar R. Art. X § 9 Rule 1.14 (1997). Texas attorneys deposited their clients' funds in commingled, non-interest-bearing trust accounts. Basic trust principles mandate that, if Texas law requires attorneys to invest client trust

² "What makes the right to mine coal valuable is that it can be exercised with profit." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 414 (1922).

funds, the interest generated belongs to the clients. Although attorneys might pass along to the client the administrative costs associated with maintaining a trust account, they would do so regardless of the existence of an IOLTA program. The only difference being that, if attorneys passed on these costs before implementation of IOLTA, clients could offset these costs with the interest they earned from the trust account. In some cases, the interest would be in excess of the costs, thereby bestowing a benefit upon the client. "It follows that although clients may have had no state-created right to earn interest in the first place, they did have 'existing rules and understandings' which entitled them to interest if any was in fact earned." Sinibaldi, *The Takings Issue in California's Legal Services Trust Account Program*, 12 Hastings Const.L.Q. 463, 489 (1985).

Furthermore, properly invested capital almost always produces income. See *In re Interest on Trust Accounts*, 402 So.2d 389, 399 (Fla. 1981) (Boyd, J., dissenting). Indeed, prior to the creation of IOLTA accounts, financial institutions received the benefit of the income from client accounts because the deposits did not earn interest. See Kreider, *Florida's IOLTA Program Does Not "Take" Client Property for Public Use*, 57 U.Cin.L.Rev. 369, 389 (1988). This inconsistency is ignored by TEAJF.

The second fallacy in TEAJF's argument is that it assumes that a client's inchoate rights to income is not property. See Palmer, *A Critique of Interest on Lawyer's Trust Accounts Programs*, 44 La.L.R. 999, 1009 (1984). Under the two-tiered standard, however, entirely incorporeal or inchoate interests have been recognized as "private property" subject to constitutional protection. See,

e.g., *Goss v. Lopez*, 419 U.S. 565 (1975) (suspension from school deprived students of property interest in education). The Texas Constitution also recognizes a client's inchoate right to income. See, *State v. Biggar*, 848 S.W.2d 291 (Tex.3rd App.Dist. 1993).

It is obvious, therefore, that the interest generated by IOLTA accounts is Summers' property because his money is held in those accounts.

1. A Mutual Understanding Exists Concerning Interest Earned On Summers' IOLTA Account.

TEAJF argues that allocating the interest generated through IOLTA accounts to the clients is impractical because the additional costs of sub-accounting each client's *pro rata* share dissipate the benefit. According to this theory, IOLTA requires financial institutions to pay interest on these accounts, whereas the institutions previously were able to use this money without paying interest. If the interest were given to the clients, rather than to TEAJF, then attorneys would incur additional fees and expenses associated with the administration and distribution of those funds. According to TEAJF, this result justifies allocating the earnings to political organizations.

TEAJF's theory, however, rests solely on practical, rather than legal, support. See Sinibaldi, *supra*, at 490. "It assumes that Summers will receive no benefit whatsoever from investing his nominal or short-term funds because it will cost him more than he will gain in interest." *Id.* at 491.

Personal computer programs are more than capable of assisting lawyers in distributing interest to its respective owner. "Indeed, some financial institutions now furnish such services to customers." Palmer, *supra*, at 1008 n.6.

While it may be impractical to require attorneys to endure added costs, this does not mean that Summers has no property interest in the income generated from his IOLTA account within the meaning of the Taking Clause.

At this level, TEAJF urges that as the program currently operates, Summers has only a unilateral expectation in the interest earned on his IOLTA account, and thus no mutual understanding exists to give rise to a property interest. Because of enhanced banking techniques and increased competition among banking institutions, however, Summers does have an expectation that he will receive interest earned from any short-term account, including an IOLTA account. See *In re Interest on Trust Accounts*, 402 So.2d at 399 (Boyd, J., dissenting); Kreider, *supra*, at 389-391.

Banking institutions easily could trim costs by realizing greater efficiency in managing IOLTA accounts. For instance, "institutions holding several IOLTA accounts could . . . lump[] the quarterly payment of interest on all the institution's IOLTA accounts into a single transfer, with itemized reporting as to the source and allocation of the earnings." *Id.* at 390.

If banks can today profitably offer NOW accounts to individuals, with smaller than average balances, there is no reason to suppose that such accounts would be unprofitable or more

costly in the IOLTA context, where the average balance will in all probability be larger than the balances in individual household's NOW accounts.

Id. at 391 n.127. Further, increased competition among banking institutions reduces the cost of managing IOLTA accounts. *Id.* at 391.

Because banks are forced to change their operating habits, becoming more efficient, in order to compete effectively, deregulation of the banking industry has altered greatly depositor expectations concerning interest on their short-term nominal deposits. *Id.*

In the future, increased competition and technological development will increase further Summers' expectations of return on his deposited IOLTA funds. *Id.* at 393. Because of the depositors' heightened expectations of return, institutions must invest in more advanced technology and software to manage these funds, resulting in the institution's capability of offering higher rates of return on all depositor's funds at lower cost. *Id.* Therefore, all investors of small amounts of money, including Summers, expect higher rates of return on their deposits. *Id.*

Contrary to this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), TEAJF's theory seemingly redefines property as an interest that must necessarily benefit its owner. See Sinibaldi, *supra*, at 492. A state may not, however, redefine property in order to "appropriat[e] [such fund] for the [state] the value of the use of the [principal] fund for the period in which it is held." *Webb's*, 449 U.S. at 164. The fact that the interest

may be small does not justify allocating the funds to benefit political organizations without Summers' consent. Sinibaldi, *supra*, at 492-493.

a. Variable Factors Cannot Determine A Property Interest.

Inherent in TEAJF's analysis is the notion that an individual's property interest depends upon variable factors such as tax laws, administrative fees, technological advances, or changing competition among banking institutions. TEAJF argues that because these factors, at present, do not lend to a profitable IOLTA program for clients, Summers does not have a property interest in the income generated from those funds. An individual's property interest, however, has never depended on variable factors. An individual's property interest arguably might be subject to existing limitations, such as contract hindrances or navigability of water. See *Perry v. Sinderman*, 408 U.S. 593, 601-02 (1971); *United States v. Cress*, 243 U.S. 316, 330 (1917). A pre-existing limitation that devalues property at the outset, however, is wholly distinguishable from a law or a technological change that, even though variable, would seemingly define a property interest depending on the status of such law or technological advance. According to the theory advanced by TEAJF, the client's property interest in IOLTA earnings would depend upon the severity of the tax laws or the status of competition among banks. This is erroneous.

1) Petitioners' Bank Analogy Is Untenable.

Arguing by analogy that banks use a depositor's money in a checking account on which interest is not paid is not an apt analogy. The relationship between bank and depositor is contractual, created by express written agreement. The funds deposited, in essence, cease to belong to the depositor, but, rather, belong to the bank, subject to the terms of the agreement. The bank is obligated, under the depository agreement, to pay interest. If the bank fails, the depositor loses his or her money and is no more than a creditor, unless insurance is in place, in which event the insurance will ensure the repayment of the money. This is inapposite from the situation presented here. Unlike the banking deposit, the IOLTA account is not controlled by agreement. The client has no say in where his funds are deposited, whether they earn interest, or who gets the interest.

Furthermore, it is contrary to the immutable concept of property that property's existence depends on the discretion of one person, the attorney with whom the money is deposited in trust. Whether Summers' account earns interest or not depends on the lawyer's determination of what is a "nominal amount" and what is a "short period of time." TEAJF would argue that this discretion is guided by the principle that it is nominal, or a short period of time, if the amount and the time together will not result in payment of interest in excess of the administrative costs associated with such a deposit. While a banker might be able to make such a determination, a busy solo practitioner is normally not so qualified, nor so

inclined. This determination also apparently hinges on whether the lawyer in question has a number of other clients making trust account deposits, so that it can be pooled and the costs of administration spread. It would seem that interest could be earned in all cases, under these circumstances. This is so because, generally, the account is required by the attorney for his or her financial protection. Accordingly, the administrative costs of accounting for interest to the clients earned on the account most often will not be passed on to the client. Thus, the only cost is the service fee, which is usually a very small amount. There are, then, few, if any, sums that could be deposited without earning net interest, and the underpinning of the arguments of TEAJF is washed away.

Accordingly, whether an object is property or not would depend on the extent of the practice of the lawyer. If he or she has many clients, interest will be earned as part of a pooled account. If he or she does not, then interest earned will belong to Texas. Surely, whether a client has property or not cannot depend upon such vagaries unassociated with the character of property in question.

B. This Court Has Determined That Even *De Minimus* Property Rises To The Level Of A Legitimate Claim Of Entitlement.

TEAJF further argues that the value of the property involved determines whether there is a cognizable property interest. TEAJF argues that the interest at issue here is so negligible as not to be cognizable property under

state law. TEAJF's argument is contrary to this Court's recent decisions.

This Court has established, as a basic tenet of land-use jurisprudence, that certain rights are fundamental to the concept of private property. Among those fundamental rights are the right to absolute and exclusive ownership and possession of property and the right to evidence such exclusive ownership and possession by excluding others from using one's property. *Kaiser Aetna v. United States*, 444 U.S. 164, 179-80 (1979). To the extent that government agencies, or persons acting under color of law, deprive a property owner of the right to exclude others, this Court has declared such acts to be a deprivation of those fundamental rights and a taking of a property interest under the Fifth and Fourteenth Amendments to the United States Constitution, irrespective of the extent of the occupation or the identity of the interloper. *Id*; *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). This Court has further defined property as "the group of rights inhering in the citizen's relation to the physical thing, as the right to possess, use, and dispose of it. . . ." *United States v. General Motors Corp.*, 323 U.S. 373, 378 (1945). Of course, this Court's definition of "property" includes far more than just "physical thing[s]." This Court has recognized many non-tangible items as property as well. *United States v. Security Indus. Bank*, 459 U.S. 70 (1982) (lien); *United States Trust Co. v. New Jersey*, 431 U.S. 1, 19 n.16 (1977) (contract rights); *Mathews v. Eldridge*, 424 U.S. 319, 332 (1976) (disability benefits). "The [Fourteenth Amendment] is addressed to every sort of interest the citizen may possess," *General*

Motors Corp., 323 U.S. at 378, and includes personal property in the form of money interest. See *Webb's*, 449 U.S. 155 (1980).

Thus, this Court mandates that Summers has a right to use the IOLTA funds and to exclude others from such use. See *Palmer, supra*, at 1012. This Court has established further a right to control the use of one's property as a property right protected by the Constitution. See *Loretto*, 458 U.S. at 436; *Pruneyard Shopping Center v. Robins*, 447 U.S. 74, 82 (1980); *Kaiser*, 444 U.S. 164 (1979).

In *Pruneyard*, a shopping center owner evicted students for distributing pamphlets and soliciting petitions for a cause with which the shopping center disagreed. The students sued, claiming the owner violated their first amendment rights. The owner appealed to this Court, arguing that the right to exclude others from his property was a fundamental property right that the state could not deny him without due process nor take from him without just compensation. This Court held that the owner did have a property right. This Court held: "one of the essential sticks in the bundle of property rights is the right to exclude others." *Pruneyard*, 447 U.S. at 82 n.6. Therefore, Summers not only has a right to use the IOLTA funds and to exclude others from such use, but he also has a right to control TEAJF's use of those funds.

Contrary to TEAJF's contention, this Court's decision in *Pruneyard* supports the proposition that Summers has a property interest in the income generated from his IOLTA account. As the students in *Pruneyard* used the shopping center owner's property, TEAJF uses Summers' property. See *Palmer, supra*, at 1014. As the shopping center owner

had a property right to deny the students use of the shopping center, Summers has a property right to deny TEAJF the use of his funds. *Id.*

This Court's decision in *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980), firmly established this proposition. In *Webb's*, this Court specifically addressed whether a statute that took interest earned on a privately owned principal fund violated the Constitution. *Webb's* involved a Florida statute that provided that "[a]ll interest accruing from moneys deposited [in Florida court registries] shall be deemed income of the office of the clerk of the circuit court . . ." Fla. Stat. Ann. § 28.33 (West 1974). Eckerd's of College Park, Inc., agreed to purchase the assets of *Webb's Fabulous Pharmacies* but filed a complaint of interpleader when it appeared that *Webb's* debts exceeded its purchase price. Eckerd's paid the entire purchase price to the court registry. *Webb's* had no pre-existing, state-created right to interest because the only statute that permitted the fund to earn interest was the same statute that vested ownership of that interest in the court clerk.

The court clerk refused the receiver's request for the interest on that account. The Florida Supreme Court held that there was no Taking Clause violation and that the Florida county could keep the interest because the creditors had no property right, merely an expectation. This Court reversed, rejecting the notion that *Webb's* creditors had a mere "unilateral expectation" of property. *Id.* at 161. Since the principal was held "only for the ultimate benefit of *Webb's* creditors, not for the benefit of the court and not for the benefit of the county . . .", the creditors had "a state-created property right to their

respective portions of the fund." *Id.* "The State's having mandated the accrual of interest [did] not mean the State or its designate [was] entitled to assume ownership of the interest." *Id.* at 162. This Court further held that "the earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Id.* at 164. "In these passages [this Court] clearly rejected Florida's rationale that the statute takes only what it creates. See Sinibaldi, *supra*, at 485.

TEAJF's attempt to distinguish *Webb's* is misplaced. In *Webb's* this Court warned that a state cannot recharacterize the interpleader fund principal as public property while deposited in the court's registry so as to appropriate the interest thereon. *Webb's*, 449 U.S. at 164. Therefore, TEAJF cannot recharacterize Summers' IOLTA fund or interest while deposited with attorneys as public money thereby unlawfully appropriating such fund or interest for public use. See *Kreider, supra*, at 388.

This Court's holding in *Webb's* firmly establishes that Summers has a property interest in the income he has earned from his IOLTA account, an interest that is protected by the United States Constitution. First, Summers' IOLTA funds are private property, like the funds deposited into the court in *Webb's*. See *Palmer, supra*, at 1015. Second, Summers retains his ownership of the funds deposited with his attorney. *Id.* Third, Summers has a state-created right to the funds that is protected by Texas law. *Id.* Fourth, "the income earned on the [IOLTA account] is 'the fruit of the funds' use." *Id.* Therefore, Summers' inchoate right to the income is a property interest protected by the Fourteenth Amendment. *Id.*

The practical effect of TEAJF's contention that the Fourteenth Amendment does not protect *de minimis* amounts of property is that client's property will not be accorded Fourteenth Amendment protection until it reaches a certain economic level. This result does not comport with recent decisions by this Court.

The *de minimis* concept, urged by TEAJF, has no relevancy to relations between individual and government. See *United States v. Lamb*, 294 F.Supp. 419 (E.D.Tenn. 1968). In recent Taking Clause challenges, this Court has analyzed the nature of the property interest taken, rather than its economic value. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). Furthermore, contrary to TEAJF's contention, the *Webb's* decision creates a rule that is independent of the amount or value of the interest at issue, holding that a property interest existed in the accrued income simply because "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Webb's*, 449 U.S. at 164.

In *Loretto*, defendants argued that cable television equipment on plaintiff's building was so small that it did not impair his constitutional interest. *Loretto*, 258 U.S. 438 n.16. This Court held that the size of the interest invaded was a matter of degree rather than of principle. *Id.* at 436-437. In so holding, this Court found that the value of the property involved does not affect the determination of whether a property interest exists. Also, this Court held that "constitutional protection for the rights of private property cannot be made to depend on the size of the area permanently occupied." *Id.* at 436.

This Court, in *Nollan v. California Coastal Commission*, 483 U.S. 825, 831-32 (1987), reaffirmed its rationale in *Loretto* by holding "our cases universally have found a taking to the extent of the occupation, without regard to whether the action achieves an important public benefit or has only minimal economic impact on the owner." *Id.* at 831 (quoting *Loretto*, 458 U.S. at 434-35).

In fact, this Court recently held that an amount as little as \$23.50 was worthy of Fourteenth Amendment protection. See *Parratt v. Taylor*, 451 U.S. 527 (1981). Most recently, this Court held that an analysis to determine whether the resale value of household goods was too low to merit protection under the Taking Clause contradicted state law property characterizations. *Security Industrial Bank*, 459 U.S. at 76.

"It therefore appears that [Summers'] traditional property right in using and controlling the uses of [his interest] cannot be denied because of its small economic value." Sinibaldi, *supra*, at 489.

II. PER SE TAKING.

In order for the IOLTA program to violate the Taking Clause, TEAJF must have "taken" Summers' property.

This Court has held that a physical invasion of an individual's property is a taking. See *Loretto*, 458 U.S. 419 (1982). In *Loretto*, this Court held that the government's permanent physical occupation of the owner's property was a *per se* taking. *Id.* at 432. In so holding, this Court found that a cable company had physically invaded property by using space for its cable boxes and wires. This

Court held that the physical invasion amounted to a permanent occupation and that the *per se* rule applied, even though the equipment occupied only a small amount of space. *Id.* at 425-426.

TEAJF urges that Summers has no property interest because he has no reasonable expectation of receiving interest from his IOLTA account. Summers' reasonable expectation, however, may only come into play after a property interest has already been found. See *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005-1006 (1984). Even then, contrary to TEAJF's contention, the *per se* rule, outlined in *Loretto*, applies here. First, the physical invasion approach defines a compensable taking whenever government "occupies, uses or in some manner takes physical possession" of the private property. A "forced contribution" of income of the IOLTA account funds obviously passes this test. See *Webb's*, 449 U.S. at 163-165. Furthermore, the IOLTA program physically invades Summers' funds and his right to the interest because TEAJF takes possession of the property right to receive the interest. See *Palmer, supra*, at 1017. That interest is withheld from Summers. Texas allows TEAJF to take possession of that interest. That intangible property is solely possessed and controlled by TEAJF.³ The substance of the IOLTA program is that TEAJF appropriates and uses, for its own purposes,

³ A physical invasion of incorporeal property occurs when the government possesses or destroys the incorporeal interest. See Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 Harv.L.Rev. 1165, 1184, n.37 (1967).

interest from a private account. Such possession and control constitute a physical invasion, even if it affects only a small amount of money. *Id.*, citing *Loretto*, 458 U.S. at 440, 435-436; *Webb's*, 449 U.S. at 163.

Furthermore, the physical invasion amounts to a permanent occupation of Summers' right to the income because Texas not only possesses the income but ensures that Summers has no possibility of ever possessing it.⁴ *Id.* at 1018. This type of deprivation is also a permanent occupation of Summers' interest. *Id.* Indeed, anytime the state takes income from funds deposited by a client, the state has made an unlawful taking. *Webb's*, 458 U.S. at 438 n.16. The fact that the amount taken is small does not mean it is "not of constitutional significance." *Id.*

This Court has never upheld a permanent physical occupation of private property, "no matter how minute, and no matter how weighty the public purpose behind it, without payment of just compensation." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992). Indeed, "[t]he Fifth Amendment's guarantee . . . was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40 (1960).

Where the *per se* theory results in a finding that a taking has occurred, courts cannot apply other theories.

⁴ "[T]he permanent physical occupation of property forever denies the owner any power to control the use of property; he not only cannot exclude others, but can make no non-possessory use of the property." *Webb's*, 458 U.S. at 436.

See *Loretto*, 458 U.S. at 435. Since in this case there is a taking under the *per se* theory, other theories do not apply. See *Palmer, supra*, at 1020. To hold otherwise would produce the "danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." *Id.*; *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 416 (1922). Therefore, contrary to TEAJF's contention, Summers' reasonable expectations are irrelevant to this analysis.

CONCLUSION

MSLF strongly believes that, both to protect the rights of Respondents and to secure the fundamental rights of all property owners from unwarranted incursions by state and federal government, this Court must uphold the Fifth Circuit's conclusion that Summers has a property interest in the earnings on his IOLTA deposit.

Respectfully submitted,

BOBAC A. BARJESTEH

WILLIAM PERRY PENDLEY*

*Counsel of Record

MOUNTAIN STATES LEGAL FOUNDATION

707 Seventeenth Street, Suite 3030

Denver, Colorado 80202

(303) 292-2021

Attorneys for Amicus Curiae

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ,
HON. NATHAN L. HECHT, HON. JOHN CORNYN, HON.
CRAIG T. ENOCH, HON. ROSE SPECTOR, HON.
PRESCILLA R. OWEN, HON. JAMES A. BAKER, HON. GREG
ABBOTT, TEXAS EQUAL ACCESS TO JUSTICE
FOUNDATION, AND W. FRANK NEWTON, IN HIS
OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS
EQUAL ACCESS TO JUSTICE FOUNDATION,
Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
SUMMERS, AND MICHAEL J. MAZZONE,
Respondents.

On Writ of Certiorari to the United States
Court of Appeals for the Fifth Circuit

**BRIEF AMICUS CURIAE OF PACIFIC LEGAL
FOUNDATION IN SUPPORT OF RESPONDENTS**

STEPHEN E. ABRAHAM

Of Counsel

Pacific Legal Foundation

2151 River Plaza Drive, Suite 305

Sacramento, California 95833

Telephone: (916) 641-8888

Facsimile: (916) 920-3444

* JAMES. S. BURLING

*Counsel of Record

R. S. RADFORD

Pacific Legal Foundation

2151 River Plaza Drive, Suite 305

Sacramento, California 95833

Telephone: (916) 641-8888

Facsimile: (916) 920-3444

*Attorneys for Amicus Curiae**Pacific Legal Foundation***BEST AVAILABLE COPY**

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QUESTIONS PRESENTED FOR REVIEW

Whether the state's use of private funds held by attorneys in escrow for their clients implicates the Takings Clause of the Fifth Amendment to the United States Constitution.

No. 96-1578

IN THE
Supreme Court of the United States
 OCTOBER TERM, 1997

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ,
 HON. NATHAN L. HECHT, HON. JOHN CORNYN, HON.
 CRAIG T. ENOCH, HON. ROSE SPECTOR, HON.
 PRESCILLA R. OWEN, HON. JAMES A. BAKER, HON. GREG
 ABBOTT, TEXAS EQUAL ACCESS TO JUSTICE
 FOUNDATION, AND W. FRANK NEWTON, IN HIS
 OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS
 EQUAL ACCESS TO JUSTICE FOUNDATION,
Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R.
 SUMMERS, AND MICHAEL J. MAZZONE,
Respondents.

On Writ of Certiorari to the United States
 Court of Appeals for the Fifth Circuit

**BRIEF AMICUS CURIAE OF PACIFIC LEGAL
 FOUNDATION IN SUPPORT OF RESPONDENTS**

Pursuant to Supreme Court Rule 37, Pacific Legal Foundation (PLF) respectfully submits this brief amicus curiae in support of respondents. Consent has been granted by all of the parties: Mr. Richard Samp on behalf of Washington Legal Foundation and Mr. William Summers; Mr. Michael Mazzone *pro se*; Mr. Darrell Jordan on behalf of the Texas Equal Access to Justice Foundation, and Mr. W. Frank Newton; and the

Attorney General for the State of Texas for the Justices of the Texas Supreme Court. The consent letters have been lodged with the Clerk of this Court.

IDENTITY AND INTEREST OF AMICUS CURIAE

Pacific Legal Foundation is a nonprofit, tax-exempt corporation organized under the laws of the State of California for the purpose of litigating in the public interest. PLF has over 25,000 supporters nationwide. Policy for PLF is set by a Board of Trustees composed of concerned citizens, many of whom are attorneys. PLF's Board of Trustees evaluates the merits of any contemplated legal action and authorizes such legal action only when the Foundation's position has broad support within the general community. PLF's Board of Trustees has authorized the filing of a brief amicus curiae in this case.¹

PLF has participated in numerous cases involving constitutional protection of property rights before this Court. Particularly noteworthy of PLF's involvement in land use and the Takings Clause cases, PLF attorneys were counsel of record in *Nollan v. California Coastal Commission*,² and *Suitum v. Tahoe Regional Planning Agency*.³ PLF attorneys also represent petitioners in *Kim v. City of New York*.⁴ PLF

¹ Pursuant to Supreme Court Rule 37.6, amicus curiae Pacific Legal Foundation affirms that no counsel for any party in this case authored this brief in whole or in part; and furthermore that no person or entity has made a monetary contribution specifically for the preparation or submission of this brief.

² 483 U.S. 825 (1987).

³ 65 U.S.L.W. 4385 (U.S. May 27, 1997) (No. 96-243).

⁴ Appeal docketed, No. 96-1794.

participated as amicus curiae in *Agins v. City of Tiburon*,⁵ *Keystone Bituminous Coal Association v. DeBenedictis*,⁶ *Hodel v. Irving*,⁷ *First English Evangelical Lutheran Church of Glendale v. Los Angeles County*,⁸ *Lucas v. South Carolina Coastal Council*,⁹ *Dolan v. City of Tigard*,¹⁰ and *Babbitt v. Youpee*.¹¹

PLF seeks to augment the argument in support of the petitioner. PLF believes that its public policy perspective and litigation experience in support of property rights will provide an additional needed viewpoint with respect to the issues presented by this case.

STATEMENT OF THE CASE

The State of Texas' Interest on Lawyers' Trust Accounts (IOLTA) program requires lawyers to pool and deposit certain client funds into special interest-bearing accounts.¹² The state then commandeers the use of these depositors' property to generate interest that is paid to the Texas Equal Access to Justice Foundation (Foundation). The

⁵ 447 U.S. 255 (1980).

⁶ 480 U.S. 470 (1987).

⁷ 481 U.S. 704 (1987).

⁸ 482 U.S. 304 (1987).

⁹ 505 U.S. 1003 (1992).

¹⁰ 512 U.S. 374, 114 S. Ct. 2309 (1994).

¹¹ ___ U.S. ___, 117 S. Ct. 29 (1996).

¹² Tex. State Bar Rules Art. XI, § 5 (1997); Tx. R. Equal Access to Justice, Rule 6 (1997).

state's use of these private deposits through its mandatory IOLTA program generates revenue of as much as \$10 million for the Foundation each year.¹³

Respondents object to the IOLTA program on the grounds that it constitutes an impermissible taking of private property in violation of the Fifth Amendment of the United States Constitution.¹⁴ The Court of Appeals for the Fifth Circuit agreed, ruling that clients have a constitutionally protected property interest in the proceeds earned from the use of their funds in IOLTA accounts.¹⁵

SUMMARY OF ARGUMENT

The Takings Clause of the Fifth Amendment to the United States Constitution is invariably violated "when some productive attribute or capacity of private property is exploited for state-dictated service."¹⁶ The question raised by the present case is whether the owners of private funds, deposited in trust accounts and impressed into public service by the Texas IOLTA program, somehow lose an essential element of the

¹³ *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, 94 F.3d 996, 998-99 (5th Cir. 1996).

¹⁴ The Takings Clause of the Fifth Amendment provides that "private property [shall not] be taken for public use without just compensation." U.S. Const. Amend. V. The Fifth Amendment applies to the states through the Fourteenth Amendment. See *Chicago, Burlington & Quincy Railroad Co. v. Chicago*, 166 U.S. 226, 235-37 (1897).

¹⁵ *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, 94 F.3d at 1003-04.

¹⁶ Jed Rubenfeld, *Usings*, 102 Yale L. J. 1077, 1114-15 (1993).

ownership of property and become less deserving of protection under the Takings Clause than owners of other forms of property.

One of the most essential attributes of private ownership is the right to make economically beneficial use of what one owns.¹⁷ A necessary corollary of this right is the ability to exclude others from making beneficial use of one's property--a fundamental interest which this Court has frequently held cannot be abridged without implicating the Fifth Amendment.¹⁸ The Texas IOLTA program impresses private funds into public use, using the earnings on these funds to pay for indigent legal services. Regardless of the legitimacy of the state's interest in this program, the means employed by the IOLTA scheme to use private property to finance a public program of legal services violates fundamental property interests protected by the Fifth Amendment.

¹⁷ *Agins v. City of Tiburon*, 447 U.S. at 260; *Lucas v. South Carolina Coastal Council*, 505 U.S. at 1031.

¹⁸ *Nollan v. California Coastal Commission*, 483 U.S. at 831; *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 433 (1982); *Kaiser Aetna v. United States*, 444 U.S. 164, 180 (1979).

ARGUMENT

**BY APPROPRIATING THE USE OF
PRIVATE FUNDS TO GENERATE
REVENUE TO FINANCE PUBLIC
SERVICES, TEXAS' IOLTA PROGRAM
IMPLICATES THE TAKINGS CLAUSE OF
THE FIFTH AMENDMENT TO THE
UNITED STATES CONSTITUTION**

**A. The Fifth Amendment Protects
the Right of Private Property
Owners to Make Economically
Beneficial Use of What They Own and to
Exclude Others from Making Beneficial
Use of Their Property**

The Takings Clause of the Fifth Amendment provides that private property shall not be taken for public use without just compensation. One of the reasons for this provision is to prevent government, under the rationale of adjusting the benefits and burdens of economic life, from

forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.¹⁹

One of the essential attributes of ownership protected by the Takings Clause is the right to make use of what one owns. This Court has frequently observed that government actions

¹⁹ *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

that preclude an owner from making economically beneficial use of his property violate the Fifth Amendment.²⁰

Conversely, this Court has consistently interpreted the Takings Clause to uphold the right of property owners to exclude others--most notably the government--from using their property. As Justice Brandeis observed, "[a]n essential element of individual property is the legal right to exclude others from enjoying it."²¹ This interest, "so universally held to be a fundamental element of the property right," cannot be abridged by the state without implicating the Fifth Amendment.²²

**B. The Appropriation of the
Economically Beneficial Use of
Private Property by Government
Implicates the Takings Clause**

When a state, by law, denies owners the right to make beneficial use of their own property while simultaneously appropriating the use of that property to itself, that state has abridged the property owner's fundamental right to exclude.²³

²⁰ *Lucas*, 505 U.S. at 1016 (citing *Agins v. City of Tiburon*, 447 U.S. at 260) (the Fifth Amendment is violated by regulations that deny an owner economically viable use of his property).

²¹ *International News Service v. Associated Press*, 248 U.S. 215, 250 (1918) (Brandeis, J., dissenting).

²² *Kaiser Aetna v. United States*, 444 U.S. at 179-80. See also *Dolan v. City of Tigard*, 512 U.S. at 384 (the right to exclude others is "one of the most essential sticks in the bundle of rights that are commonly characterized as property") (quoting *Kaiser Aetna*, 444 U.S. at 176).

²³ See *Preseault v. Interstate Commerce Commission*, 494 U.S. 1, 24-25 (1990) (O'Connor, J., concurring) (government's burdening of property that interferes with the right to exclude implicates the Fifth Amendment).

In *United States v. Causby*,²⁴ military aircraft flew training missions over the Causbys' property, preventing the owners from making beneficial use of their land as a chicken farm.²⁵ This Court held there was a taking requiring payment of just compensation because the farm was effectively appropriated for use by the military's training operations.²⁶

Similarly, in *Loretto v. Teleprompter Manhattan CATV Corp.*,²⁷ this Court held that a law permitting a third party to make use of a rooftop against the owner's will constituted a taking of property for which just compensation was required.²⁸ Even though the plaintiff in *Loretto* lost the use of a space amounting to slightly more than 1½ cubic feet, the state's intrusion on the right to exclude was found to implicate--and indeed to violate categorically--the Takings Clause.²⁹

²⁴ 328 U.S. 256 (1946).

²⁵ *Id.* at 259.

²⁶ [An easement of flight] would be a definite exercise of complete dominion and control over the surface of the land. The fact that the planes never touched the surface would be [] irrelevant The owner's right to possess and exploit the land--that is to say, his beneficial ownership of it--would be destroyed. ... In the supposed case the line of flight is over the land. And the land is appropriated as directly and completely as if it were used for the runways themselves.

Id. at 262.

²⁷ 458 U.S. at 419.

²⁸ *Id.* at 421.

²⁹ *Id.* at 438 n.16.

C. The Texas IOLTA Program's Use of Private Funds Implicates the Takings Clause

1. Texas' IOLTA Program Precludes Private Depositors from Earning Interest While Appropriating to the State the Beneficial Use of Their Funds

Texas law does not preclude the earning of interest on private deposits. Rather, under the Texas IOLTA rules, client funds are pooled into an account for the benefit of the IOLTA program.³⁰ This account does not differ fundamentally from any other type of demand deposit save for the fact that it consists of privately owned funds impressed into public service.

If the IOLTA program did not exist, attorneys could employ their clients' funds for the fund owners' benefit. It is only because of the IOLTA rules that these deposits are not utilized to earn interest for the benefit of their owners. Instead the use of the deposits is exploited by the government to pay for a public program that does not directly benefit the property owners. This usurpation of the use of private property by the state, no matter what the measure of public good served, is inconsistent with this Court's interpretation of the Takings Clause.

2. The Value of the Individual Deposits Is Irrelevant

The State of Texas and its amici contend the IOLTA scheme does not implicate the Takings Clause because the private funds appropriated for use by the state may be in

³⁰ Texas State Bar Rule 5(A).

amounts so small as to make the earning of interest by the individual depositors impracticable. However, as the Fifth Circuit in this case correctly observed, the Fifth Amendment does not place a minimum value on property protected under the Constitution.³¹

This Court has also rejected efforts to read a *de minimis* term into the Fifth Amendment. As previously noted, the Takings Clause was found to be violated in *Loretto* despite the minuscule area of the plaintiff's rooftop that had been appropriated for use to benefit the public.³² Likewise, in *Hodel v. Irving*, this Court held that portions of the Indian Land Consolidation Act violated the Takings Clause even though the value of the individual ownership interests was *de minimis*.³³

Owners of financial deposits, no less than owners of land, are protected by the Constitution against having their property pressed into service by the government, to be put to economic use for the benefit of the state.

CONCLUSION

Although federal banking rules permit individuals to earn interest on short term deposits of small amounts of money, the State of Texas prohibits one class of depositors from earning such interest. Instead, Texas commandeers the use of these depositors' property and employs the federal banking rules to earn interest for the state. Thus, Texas prohibits economically beneficial use of these private deposits by the owners and instead coopts such use exclusively for itself. Such

³¹ *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, 94 F.3d at 1002 (footnote omitted).

³² 458 U.S. at 438.

³³ 481 U.S. at 714.

a scheme implicates the Fifth Amendment's protection of the right to make beneficial use of one's private property and to exclude others.

The Texas IOLTA program declares that clients entrusting to their attorneys certain funds have no property interests in the use of those funds. However, a state cannot defeat the constitutional prohibition against using property without just compensation by the simple device of asserting that the property owner had no right to the use or the profits therefrom.³⁴ The state's impressing of privately deposited funds into public service does not differ in kind from a law that impresses a coal mine or a rooftop into public service.

This case presents this Court with the opportunity to reaffirm that the Takings Clause is violated when private property is impressed into public service. This Court should affirm the decision of the Court of Appeals holding that the Texas IOLTA program implicates the Fifth Amendment.

DATED: October, 1997.

Respectfully submitted,

STEPHEN E. ABRAHAM
Of Counsel
Pacific Legal Foundation
2151 River Plaza Drive,
Suite 305
Sacramento, California 95833
Telephone: (916) 641-8888
Facsimile: (916) 920-3444

*JAMES S. BURLING
*Counsel of Record
R. S. RADFORD
Pacific Legal Foundation
2151 River Plaza Drive,
Suite 305
Sacramento, California 95833
Telephone: (916) 641-8888
Facsimile: (916) 920-3444

*Attorneys for Amicus Curiae
Pacific Legal Foundation*

³⁴ *Hughes v. Washington*, 389 U.S. 290, 296-97 (1967) (Stewart, J., concurring).

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No. 96-1578

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Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, *et al.*,
Respondents.

On Writ Of Certiorari
To The United States Court of
Appeals For The Fifth Circuit

BRIEF OF THE HONORABLE ROBERT E. TALTON *et al.*,
AS INDIVIDUAL MEMBERS OF THE HOUSE OF
REPRESENTATIVES OF THE STATE OF TEXAS,
AS AMICI CURIAE SUPPORTING RESPONDENTS

MARK W. SMITH
STEVEN B. EICHEL
919 Third Avenue
New York, NY 10022
(212) 735-2006

STEPHEN R. McALLISTER*
University of Kansas School of Law
Green Hall
Lawrence, KS 66045
(785) 864-4550

**Counsel of Record*

Counsel for Amici Curiae

APPELLATE ADVANTAGE

3723 N. OAK TRAFFICWAY ♦ KANSAS CITY, MO 64116 ♦ 816-453-2424

BEST AVAILABLE COPY

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1997

No. 96-1578

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ON WRIT OF CERTIORARI TO THE
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et al., AS INDIVIDUAL MEMBERS OF THE
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AS AMICI CURIAE SUPPORTING RESPONDENTS

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INTEREST OF THE *AMICI*

Amici curiae Robert E. Talton, Kent Grusendorf, Bob Hunter, John Shields, Terry Keel, Arlene Wohlgemuth, Mary Denny, Talmadge L. Heflin, Jim Horn, Eugene J. Seaman, Ted Kamel, and Gary Elkins serve as duly-elected members of the House of Representatives for the State of Texas.¹

As members of the Texas House of Representatives, these *amici* have a direct interest in (i) ensuring that statutes enacted by the Texas Legislature are not ignored or violated by any person, entity, or governmental branch, including the Supreme Court of Texas, (ii) protecting their policy-making authority and legislative function from intrusions by the Texas Supreme Court, and (iii) preserving the sanctity of private property rights. Although *amici* believe that helping the indigent receive appropriate legal assistance is an important public policy goal, achieving this policy goal is entrusted by the Texas Constitution to the state legislature --

¹ Pursuant to Rule 37.6 of this Court, counsel for *amici* certify that counsel for the respondents did not author any part of this brief, and that no person or entity, other than *amici* and their counsel, contributed monetarily to the preparation and submission of this brief. Sup. Ct. R. 37.6. As a courtesy, prior to filing the brief, counsel for *amici* did send a draft copy of the brief to respondents' counsel.

The parties have consented to the filing of this brief, and their letters of consent are on file with the Clerk.

an institution with superior policy-making capabilities -- not the Texas Supreme Court.

STATEMENT OF THE CASE

Amici adopt the statement of the case set forth in Respondents' brief.

SUMMARY OF ARGUMENT

By order of the Supreme Court of Texas, dated December 13, 1988, the Texas State Bar Rules were amended to make the voluntary Texas Interest on Lawyers Trust Accounts ("IOLTA") program mandatory. In order to amend the Texas State Bar Rules, the Texas Supreme Court was obligated to comply with § 81.024 of Texas' Government Code. Section 81.024 of Texas' Government Code requires that (i) the registered members of the State Bar be permitted to vote on all proposed Bar Rules and (ii) at least 51 percent of the registered members of the State Bar actually vote on the proposed Bar Rule. See Tex. Gov't Code Ann. § 81.024 (West 1988). Unless these two conditions are satisfied, a proposed Bar Rule may not be promulgated by the Texas Supreme Court. See Tex. Gov't Code Ann. § 81.024(g) (West 1988). Here, in mandating participation in the IOLTA program, the Texas Supreme

Court amended the Bar Rules without complying with a duly enacted, clearly applicable state statute.

Besides failing to comply with § 81.024, the Texas Supreme Court exceeded its authority when it redirected the interest income generated in IOLTA accounts to the Texas Equal Access to Justice Foundation ("TEAJF") for distribution to various legal service organizations. By taking the IOLTA interest income from those clients whose funds generated the interest, the Texas Supreme Court imposed, in effect, a 100% tax on the net income generated by each client's principal. These *de facto* tax revenues would then be given to TEAJF, acting as a state agent, for distribution to organizations that it deemed worthy of public subsidies. In creating this arrangement, the Supreme Court exceeded its authority because the Texas Constitution authorizes only the legislature -- not the judiciary -- to implement tax and spend policy.

In addition to this constitutional imperative, the Texas State Legislature is better suited than the Texas Supreme Court to establish tax and spend policies because the Legislature has substantial latitude to accommodate competing concerns and to account for the practical ability of the state to resolve the issue at hand. The Texas Legislature is authorized and deemed competent to determine Texas' taxing and spending policy, including determining how revenue should be raised and spent to

provide basic legal services for the indigent in Texas. In fact, in fulfillment of this role, the Texas Legislature earlier this year amended chapter 51 of the Government Code to increase court filing fees in order to raise revenue to provide the indigent in Texas with legal representation. By enacting this legislation, the Texas Legislature exercised its state constitutional authority to determine the manner in which revenue will be raised and utilized on behalf of Texas' indigent. Moreover, the vast majority of legal services for Texas' indigent have been provided through voluntary *pro bono* services rather than through legal services paid for by the IOLTA program. In fact, the IOLTA program constitutes a relatively insignificant proportion of the free legal services available to Texas' indigent.

ARGUMENT

I. THE TEXAS SUPREME COURT DISREGARDED TEXAS STATUTORY REQUIREMENTS WHEN IT AMENDED THE TEXAS BAR RULES TO MANDATE LAWYER PARTICIPATION IN THE IOLTA PROGRAM

In 1988, the Texas IOLTA program became mandatory after the Texas Supreme Court amended the Texas Bar Rules in disregard of statutorily-required amendment procedures.

The Texas State Legislature enacted § 81.024 of Texas' Government Code, effective September 1, 1987, to establish requirements by which the Texas Supreme Court was permitted to amend the Texas Bar Rules. See Tex. Gov't Code Ann. § 81.024 (West 1988). Under this statute, before a proposed Bar Rule may become effective, the Texas Supreme Court is obligated to comply with the following procedures:

- (a) The supreme court shall promulgate the rules governing the State Bar. The rules may be amended as provided by this section.
- (b) The supreme court may, either as it considers necessary, pursuant to a resolution of the board of directors of _____ the State Bar, or pursuant to a petition signed by at least 10 percent of the registered members of the State Bar, prepare, propose, and adopt rules or amendments to rules for the operation, maintenance, and conduct of the State Bar and the discipline of its members.
- (c) When the supreme court has prepared and proposed rules or amendments to

rules under this section, the court shall mail a copy of each proposed rule or amendment in ballot form to each registered member of the State Bar for a vote.

- (d) At the end of the 30-day period following the date the ballots are mailed, the court shall count the returned ballots. An election is valid only if at least 51 percent of the registered members of the State Bar vote in the election.
- (e) The supreme court shall promulgate each rule and amendment that receives a majority of the votes cast in an election. The rule or amendment takes effect immediately on promulgation by the court.
- (f) The vote shall be open to inspection by any member of the bar or the public.
- (g) A rule may not be promulgated unless it has been approved by the

members of the State Bar in the manner provided by this section.

See Tex. Gov't Code Ann. § 81.024 (West 1988) (emphasis added). Under § 81.024, the Texas Supreme Court may promulgate rules governing the Texas State Bar only if it acts in accordance with the statutory procedures. See *id.*

Here, although the IOLTA program has existed since 1984, the program did not become mandatory until December 13, 1988, when the Texas Supreme Court issued an order making the program obligatory (the "IOLTA Order"). See Harold F. Kleinman & Dean W. Frank Newton, Court Orders IOLTA Conversion: An Overview of the Program, 52 Tex. Bar J. 172 (Feb. 1989); Texas Supreme Court, Order of December 13, 1988, reprinted in 52 Tex. Bar J. 173 (Feb. 1989). In issuing the IOLTA Order, the Texas Supreme Court wrote that it was acting solely "pursuant to the authority conferred on the Supreme Court by [the] Texas Constitution, Article V, § 31 and Texas Government Code § 81.011, as well as the inherent powers of this Court to regulate the practice of law." Texas Supreme Court, Order of December 13, 1988, reprinted in 52 Tex. Bar J. 173 (Feb. 1989). Conspicuously absent from the IOLTA Order was any reference to § 81.024, with which the court failed to comply in numerous respects.

Before the Bar Rules could be amended to make the IOLTA program mandatory, § 81.024 required the Texas Supreme Court to mail a copy of the proposed change to every registered member of the State Bar for a vote. See Tex. Gov't Code Ann. § 81.024(c) (West 1988). The Texas Supreme Court did not do so. Section 81.024 required the Texas Supreme Court to conduct a vote on the proposed change among the members of the State Bar. See Tex. Gov't Code Ann. § 81.024(c) & (d) (West 1988). The Texas Supreme Court did not allow a vote. Section 81.024 required that at least fifty-one percent of the registered members of the State Bar vote on the proposed rule before it could become effective. See Tex. Gov't Code Ann. § 81.024(d) (West 1988). Because the Texas Supreme Court did not put the proposed rule to a vote, fifty-one percent of the State Bar did not vote on the proposal to compel participation in IOLTA. Indeed, only nine members of the Texas State Bar were permitted to vote on the proposed rule -- that is, only those nine members of the Texas State Bar who also sat as members of the Texas Supreme Court were given the opportunity to vote on whether to mandate participation in IOLTA. In sum, the Texas Supreme Court issued the IOLTA Order in contravention of § 81.024, a

state statute enacted by the duly-elected representatives of the residents of the State of Texas.²

Insofar as *amici* are aware, since the enactment of § 81.024 of Texas' Government Code, effective September 1, 1987, the members of the Texas State Bar have had the opportunity to vote on every proposed amendment to the Texas Bar Rules except the IOLTA Order.

Amici recognize that the Texas Supreme Court's disregard of the plain requirements of a properly enacted state statute may not provide grounds for this Court to decide the constitutional questions presented in this case. Nevertheless, the Texas Supreme Court's decision to ignore the unambiguous procedures set forth in § 81.024 raises

² Ironically, the Texas Supreme Court's decision to ignore § 81.024 is inconsistent with a statement it made only months after mandating IOLTA participation. In a public proclamation welcoming comments about a proposal to adopt new disciplinary rules for the State Bar, the Texas Supreme Court stated "[t]he Supreme Court recognizes that it is important that all interested persons have fair opportunity to comment upon proposed changes before they are made." Texas Supreme Court Invites Comments on Proposed Amendments to Texas Court Rules, 52 Tex. Bar J. 1147 (Nov. 1989). Nevertheless, in responding to subsequent criticism by members of the bar for issuing the IOLTA Order without first putting the proposal to a vote of the State Bar, Texas Supreme Court Justice Raul Gonzalez explained, "[t]he court felt that any further comment would not be beneficial in weighing the interest of the [mandatory IOLTA program]." State Bar Board Meets in Galveston: Model Rules Referendum Scheduled, 52 Tex. Bar J. 320 (Mar. 1989) (emphasis added).

concern about why the court decided to unilaterally promulgate the IOLTA Order instead of giving members of the Texas State Bar an opportunity to exercise their statutory right to vote on the proposed rule change. The Texas Supreme Court's disregard of § 81.024 seems inconsistent with its general view that Texas courts may not ignore the "Legislature's unequivocal expression of intent" when such intent can be readily discerned from the language of a statute. See Trammell Crow Co. No. 60 v. Harkinson, 944 S.W.2d 631, 635 (Tex. 1997).

By depriving the individual members of the Texas State Bar the opportunity to exercise their statutory right to vote on the proposal to make the IOLTA program obligatory, the Texas Supreme Court placed its own policy preference above all others. In doing so, the Texas Supreme Court ignored the clear command of the Texas Legislature to allow members of the Texas State Bar to vote on proposed Bar Rule amendments before their promulgation.

II. THE TEXAS SUPREME COURT EXCEEDED ITS AUTHORITY WHEN IT REDIRECTED THE INTEREST INCOME GENERATED BY IOLTA ACCOUNTS TO THE TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION

A. The Texas Supreme Court Lacks The Authority To Implement Tax And Spend Policies

The Texas Constitution expressly provides for the separation of legislative and judicial functions:

The powers of the Government of the State of Texas shall be divided into three distinct departments, each of which shall be confided to a separate body of magistracy, to wit: Those which are Legislative to one; those which are Executive to another, and those which are Judicial to another; and no person, or collection of persons, being of one of these departments, shall exercise any power properly attached to either of the others, except in the instances herein expressly permitted.

Tex. Const. art. II, § 1. In providing for the separation of powers, the Texas Constitution recognizes that each of the

"three distinct departments" acts under a delegated and limited authority such that if one branch exceeds its authority by exercising powers not belonging to it, these acts are a nullity and are not binding. *See* Tex. Const. art. II, § 1 (Notes of Decisions, Infringement of Powers) (West 1997).

The separation of powers provision of the Texas Constitution is violated when "one branch of government assumes, or is delegated, to whatever degree, a power that is more 'properly attached' to another branch" or "when one branch unduly interferes with another branch so that the other branch cannot effectively exercise its constitutionally assigned powers." *Armadillo Bail Bonds v. Texas*, 802 S.W.2d 237, 239 (Tex. Crim. App. 1990) (en banc). Under the Texas Constitution, the authority to prescribe taxes rests with the duly-elected Legislature. *See, e.g.,* Tex. Const. art. VIII, §§ 1, 24; *Isbell v. Gulf Union Oil Co.*, 147 Tex. 6, 11, 209 S.W.2d 762, 765 (1948) ("power to prescribe taxes . . . rests with the Legislature"); *Texas v. Wynne*, 134 Tex. 455, 468, 133 S.W.2d 951, 958 (1939) ("[t]he burden of levying taxes rests on the Legislature, and that body has plenary power of prescribing the mode of taxation to raise revenue"), appeal dismissed, 310 U.S. 610 (1940) (per curiam). The judiciary may not interfere with the Legislature's authority unless a proposed law violates the Texas or United States Constitution. *See Isbell*, 147 Tex. at 11, 209 S.W.2d at 765 (Texas State Constitution);

Vinmar, Inc. v. Harris County Appraisal District, 947 S.W.2d 554 (Tex. 1997) (United States Constitution). Here, however, the Texas Supreme Court infringed upon the Legislature's taxing and spending authority.

Under the mandatory IOLTA program, attorneys are required under certain circumstances³ to deposit client funds in IOLTA accounts. The IOLTA funds are pooled and the interest earned on these funds is distributed by the TEAJF to various non-profit organizations which apply to the TEAJF for funding. See Washington Legal Found. v. Texas Equal Access to Justice Foundation, 94 F.3d 996, 998-99 (5th Cir. 1996), cert. granted, 117 S. Ct. 2535 (1997).

By redirecting IOLTA interest income from the clients whose funds generate the interest to TEAJF for disbursement, the Texas Supreme Court is imposing, in effect, a 100% tax on the net income generated by the clients' prin-

³ The mandatory IOLTA rules provide, in pertinent part, that:

An attorney . . . receiving in the course of the practice of law . . . client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time, shall establish and maintain a separate interest-bearing demand account at a financial institution and shall deposit in the account all those client funds.

Tex. Gov't Code Ann., tit. 2, subtit. G app. (West Supp. 1997) (State Bar Rules art. XI, § 5(A)).

cipal.⁴ In making IOLTA obligatory, the Texas Supreme Court acted in contravention of the democratic process and infringed upon the Texas Legislature's taxing authority. Cf. Missouri v. Jenkins, 495 U.S. 33, 51 (1990) ("In assuming for itself the fundamental and delicate power of taxation the District Court not only intruded on local authority but circumvented it altogether.")

The Texas Constitution grants the Texas Legislature -- not the judiciary -- the authority to enact and implement tax and spend policies. See Isbell, 147 Tex. at 11, 209 S.W.2d at 765 ("power to prescribe taxes . . . rests with the Legislature"); Tex. Const. art. VIII, § 6; see, e.g., Bullock v. Calvert, 480 S.W.2d 367, 370 (Tex. 1972) (holding that it lies within the discretion and power of the Legislature to appropriate state funds for the purpose of financing party primary elections). The Texas state judiciary may not establish a program that violates the Texas Constitution. See State Bar of Texas v. Gomez, 891 S.W.2d 243, 250 (Tex. 1994) (Hightower, Gammage, Spector, JJ., dissenting) ("[w]e have no inherent power to create a system

⁴ As respondents persuasively argue in their merits brief, under Texas state law, the interest on the deposit of principal is the property of the owner of that principal. Sellers v. County of Harris, 483 S.W.2d 242, 243 (Tex. 1972) (holding that "[t]he interest earned by deposit of money owned by the parties to the lawsuit is an increment that accrues to that money and to its owners").

that violates the Constitution"); Reese v. Texas, 772 S.W.2d 288, 290 (Tex. App.--Waco 1989, pet. ref'd) (per curiam) (reasoning that a court may not enact a procedural rule that conflicts with a provision of the Constitution); Picard v. Texas, 631 S.W.2d 761, 763 (Tex. App.--Beaumont 1981, no writ) (holding that the rule-making authority of any court may not conflict with constitutional provisions and that any unconstitutional rule is inoperative). Nevertheless, the effect of the mandatory IOLTA program is to impose a *de facto* 100% net income tax on the interest generated on clients' money involuntarily deposited into an IOLTA account. By the imposition of the *de facto* tax and the redirection of that interest to the TEAJF, the Texas Supreme Court exceeded its authority under the Texas Constitution by implementing a tax and spend policy.

B. The Texas Supreme Court Is Not The Best Governmental Institution To Establish Tax And Spend Policies For The State Of Texas

The duties and responsibilities of the legislative and judicial branches of the Texas state government are based not only upon state law but also on institutional considerations. In contrast to the Texas Supreme Court, which is designed as an institution to resolve discrete disputes between parties, the Texas Legislature is the governmental

institution most competent to make tax and spend policies such as determining how revenue should be raised and spent to provide basic legal services for the indigent in Texas. Unlike courts, legislatures have substantial latitude to accommodate competing concerns and account for limitations on the practical ability of the state to resolve social issues. See Washington v. Glucksberg, 117 S. Ct. 2258, 2293 (1997) (Souter, J., concurring) ("Legislatures . . . have superior opportunities to obtain the facts necessary for a judgment about [assisted suicide]. Not only do they have more flexible mechanisms for fact finding than the Judiciary, but their mechanisms include the power to experiment, moving forward and pulling back as facts emerge within their own jurisdictions.").

Members of the Texas Supreme Court have previously recognized the limited public policy-making capabilities of the judiciary in a context remarkably similar to the mandatory IOLTA program. In State Bar of Texas v. Gomez, indigents brought an action for declaratory and injunctive relief to require the Texas State Bar or the Texas Supreme Court to implement a mandatory *pro bono* program for Texas lawyers. Although the indigents' action did not present a justiciable controversy and, therefore, the case was dismissed because the district court lacked jurisdiction, Justice Gonzalez in concurrence eloquently noted the impropriety of the court making public policy decisions:

Mandating any program for legal services to the poor is a political question, over which this Court in its administrative capacity and the Legislature would have jurisdiction. However, in my opinion, any attempt to draft and implement such a program would unnecessarily divert the Court from its primary business of adjudicating disputes. The Legislature is better suited to undertake the activities necessary for drafting and implementing a program to provide indigent legal services. Different program options, as well as their legal and constitutional ramifications, will need to be considered. Since the problem of access to legal services faces society as a whole, the burden of resolving it does not solely rest on the legal profession.

891 S.W.2d at 247 (Gonzalez, J., concurring) (emphasis added). Likewise, this Court has repeatedly stated that the legislature is better suited to make policy decisions than the judiciary and that the role of the judiciary is to interpret the intent of the legislature rather than to make public policy. See, e.g., Washington, 117 S. Ct. at 2293 (Souter, J., concurring) ("We therefore have a clear question about which institution, a legislature or a court, is relatively more competent to deal with an emerging issue as to which facts

currently unknown could be dispositive. The answer has to be, for the reasons already stated, that the legislative process is to be preferred."); Missouri v. Jenkins, 515 U.S. 70, 132 (1995) (Thomas, J., concurring) ("Federal courts simply cannot gather sufficient information to render an effective decree, have limited resources to induce compliance, and cannot seek political and public support for their remedies.").

The Texas Supreme Court, as a government institution, is considerably less competent than the Texas Legislature to gather the information necessary to address the multitude of competing political and social interests being weighed in the enactment and implementation of tax and spend policies -- including how best to address the needs of indigents requiring legal assistance. Accordingly, the Texas Legislature, not the Texas Supreme Court, is the proper branch of government to determine for Texas the manner in which revenue should be generated and how such revenue should be spent subsidizing legal services to Texas' indigent.

C. The Texas Bar And The Texas Legislature Already Provide For The Legal Needs Of Texas' Indigent

In characterizing the respondents' arguments against the IOLTA program as a means to preclude the provision of

legal services to the poor, (Brief for Petitioners on Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit at 10-11 (Aug. 25, 1997)), petitioners exaggerate reality in an attempt to engender sympathy for this unconstitutional IOLTA program.

Like most lawyers, lawyers in Texas donate significant amounts of their time to providing free legal services for individuals who could not otherwise afford legal representation. The Texas Bar has conducted studies on the number of hours Texas lawyers donate to *pro bono* every year. In 1992, the first year the number of hours Texas lawyers billed to *pro bono* was reported, approximately eighty-nine percent (89%) of all legal services for the indigent were provided through voluntary *pro bono* services.⁶ Between 1992 and 1996 (the last year for which figures are available), the total number of hours donated by Texas lawyers to *pro bono* work increased from approximately 1,338,900 to 1,679,050 hours a year. *Id.*

In contrast, the amount of legal services the IOLTA program has been capable of providing has been falling. In 1990, the IOLTA program generated approximately \$9.3

⁶ State Bar of Texas, Department of Research and Analysis, *Pro Bono Reporting*, June 1995 through May 1996, at 3; Texas Equal Access to Justice Foundation, *Justice For All*, 1992/1993 Annual Report.

million in interest revenue. In 1993, the IOLTA program generated only approximately \$5.1 million. This substantial decrease in the amount of interest revenue generated by the IOLTA program resulted from falling interest rates. Robert Elder & Janet Elliot, Bar Wants \$10 for Legal Services, *Tx. Law.*, March 1, 1993, at 10.

To better compare the amount of legal services the IOLTA program has subsidized with the amount of legal services provided by Texas lawyers performing *pro bono* work, one need only divide the respective figures by the standard hourly billing rate that the typical Texas lawyer billed during the relevant time periods. According to one survey, the standard hourly billing rate for the typical Texas lawyer was \$140.⁷ Under the assumption that the typical Texas lawyer billed at \$140 per hour, the number of hours of legal services the IOLTA program would have been able to subsidize in 1990 would have been approximately 66,429 hours.⁷ Under this same assumption, the number of hours

⁷ See, Charles Silver, Does Insurance Defense Counsel Represent the Company or the Insured?, 72 Tex. L. Rev. 1583, 1597 n. 72 (1994) (citing State Bar of Texas, 1992 Attorney Billing and Compensation Survey: Hourly Rate Report 13 (1992)). While the \$140 per hour rate was used for the analysis set forth in this section of the brief, it is probable that the standard hourly rate for most Texas lawyers was lower in the years preceding 1992 and higher in the years after 1992.

⁸ The \$9.3 million in IOLTA interest revenue divided by the \$140 per hour billing rate equals approximately 66,429 attorney *pro bono* hours.

of legal services the IOLTA program would have been able to subsidize in 1994 would have been approximately 36,429 hours.* By comparing the 1,338,900 hours donated by Texas lawyers in *pro bono* services during 1996 with the 66,429 hours subsidized by IOLTA in 1990 or the 36,429 hours subsidized by IOLTA in 1993, it appears that in addition to being unconstitutional, the IOLTA program constitutes a relatively insignificant proportion of the free legal services available for Texas' indigent.

Moreover, unlike the Texas Supreme Court, the Texas Legislature has the authority to prescribe taxes to raise the monies necessary to run the state government -- and it has done so. In fact, earlier this year, the Texas Legislature amended chapter 51 of the Government Code to add an additional court filing fee to raise monies to provide basic legal services for Texas' indigent. Act effective Sept. 1, 1997, 1997 Tex. Gen. Laws 699 (to be codified at Tex. Gov't Code Ann. § 51.901). By enacting this provision, the Texas Legislature exercised its authority to determine the state's tax and spend policy by determining the manner in which the revenue will be generated and utilized. Accordingly, there is no need for the Texas Supreme Court to implement its own tax and spend policies in the form of mandatory IOLTA or otherwise.

* The \$5.1 million in IOLTA interest revenue divided by the \$140 per hour billing rate equals approximately 36,429 attorney *pro bono* hours.

CONCLUSION

The judgment of the United States Court of Appeals for the Fifth Circuit should be affirmed and the Texas IOLTA program should be declared unconstitutional.

Respectfully submitted,

MARK W. SMITH
STEVEN B. EICHEL
919 Third Avenue
New York, NY 10022
(212) 735-2006

STEPHEN R. MCALLISTER*
University of Kansas
School of Law
Green Hall
Lawrence, KS 66045
(913) 864-9236

**Counsel of Record*

October 10, 1997

Counsel for Amici Curiae

24

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

HON. THOMAS R. PHILLIPS, et al.,
Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, et al.,
Respondents,

On Writ of Certiorari
to the United States Court of Appeals
for the Fifth Circuit

BRIEF OF *AMICUS CURIAE*
NATIONAL RIGHT TO WORK LEGAL
DEFENSE FOUNDATION, INC.
IN SUPPORT OF RESPONDENTS

John C. Scully
National Right To Work
Legal Defense
Foundation, Inc.
8001 Braddock Road,
Suite 600
Springfield, Virginia 22160
(703) 321-8510

ATTORNEY FOR *AMICUS CURIAE*

October, 1997

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BRIEF OF *AMICUS CURIAE*
NATIONAL RIGHT TO WORK LEGAL
DEFENSE FOUNDATION, INC.
IN SUPPORT OF RESPONDENTS

INTRODUCTION

Pursuant to Rule 37.3 of the Rules of this Court, the National Right to Work Legal Defense Foundation, Inc. ("Foundation") files this brief *amicus curiae* in support of Respondents. All parties have consented to the filing of this

brief, and their letters of consent have been filed with the Court.¹

INTEREST OF THE *AMICUS CURIAE*

The National Right to Work Legal Defense Foundation is a nonprofit, charitable organization that provides free legal assistance to individual employees who, as a consequence of compulsory unionism, have suffered violations of their right to work; their freedoms of association, speech, and religion; their rights to due process of law; and other fundamental liberties and rights guaranteed by the Constitution and laws of the United States and of the several states.

The Foundation has supported this Court's major cases involving the rights of employees to refrain from joining or supporting labor organizations as a condition of employment. *Lehnert v. Ferris Faculty Ass'n*, 500 U.S. 507 (1991); *Communications Workers of America v. Beck*, 487 U.S. 735 (1988); *Chicago Teachers Union, Local No. 1 v. Hudson*, 475 U.S. 292 (1986); *Minnesota State Bd. v. Knight*, 465 U.S. 271 (1984); *Ellis v. Railway Clerks*, 466 U.S. 435 (1984); and *Abod v. Detroit Bd. of Educ.*, 431 U.S. 209 (1977). In hundreds of other cases throughout the country, the Foundation is now aiding employees who seek to limit their forced association with unions and their financial payments to those unions.

The issue before this Court is whether the taking of interest earned on Interest on Lawyer Trust Accounts ("IOLTA") constitutes a taking of Respondents' property. In addition to Fifth Amendment issues, the case raises important compelled speech issues. At least one *amici* supporting

¹ Pursuant to Rule 37.6 of the Rules of this Court, this brief was not written in whole or part by a counsel for a party to the litigation. No monetary contribution to the preparation or submission of this brief was made by any person or entity other than the *amicus curiae*.

Petitioners, The American Association of Retired Persons and the Legal Counsel for the Elderly, has urged this Court to consider the First Amendment issues and rule that Petitioners have no First Amendment rights infringed by the IOLTA programs. The National Right to Work Legal Defense Foundation argues that the First Amendment issues stand independent from the Fifth Amendment issues and urges this Court to refrain from deciding the First Amendment issues in this case.

SUMMARY OF THE ARGUMENT

The question before this Court is whether Petitioners have any property interest in the funds deposited into the IOLTA. However, this case also raises important First Amendment issues.

If, *arguendo*, this Court decides that Respondents have not had their Fifth Amendment rights abridged by the taking of the interest generated in the IOLTA, Respondents still have sufficient property rights in the funds held in the IOLTA to maintain a First Amendment claim. That is because the money generated by funds in the IOLTA is often used for political and ideological purposes. That type of activity is at the core of the First Amendment. Furthermore, the expressive nature of the litigation engaged in by organizations receiving IOLTA funds implicates First Amendment rights.

The fact that interest generated by the money of each involuntary participant in IOLTA programs might be small, or the fact that the use of the money is temporary is irrelevant when First Amendment rights are implicated. *Chicago Teachers Union, Local No. 1 v. Hudson*, 475 U.S. 292, 304-06 (1986); *Ellis v. Railway Clerks*, 466 U.S. 435, 444 (1984).

Since Respondents are forced to finance IOLTA recipient organizations, there is an impact on Respondents' First Amendment rights of freedom of speech and association. Accordingly, traditional First Amendment analysis must be

applied to this case to determine if the infringement can withstand constitutional scrutiny.

Since the First Amendment issues have not been briefed, *amicus* National Right to Work Legal Defense Foundation urges the Court to refrain from deciding important First Amendment issues raised by this case.

ARGUMENT

I. THIS CASE INVOLVES BOTH FIRST AND FIFTH AMENDMENT ISSUES BUT SHOULD BE DECIDED SOLELY ON THE FIFTH AMENDMENT QUESTION.

In the district court, Respondents made two constitutional claims challenging the IOLTA programs. First, they argued that Petitioners have infringed upon their Fifth Amendment rights by taking their property in violation of the takings clause. Secondly, they argued that by forcing Respondents to choose between using the legal system and participating in the IOLTA programs, thus providing financial support to causes with which they disagree, Petitioners violated Respondents' First Amendment rights.

The district court granted summary judgment to Petitioners on the theory that individuals who have their money placed into the IOLTA have no property rights in the interest generated from said funds. The Fifth Circuit reversed, holding that interest earned on the IOLTA is the property of the IOLTA depositor. It remanded the case to the district court for a determination whether the property was taken against the will of the property owner.

The Fifth Circuit found that individuals who have funds placed into the IOLTA do have a property interest in those funds. If the Fifth Circuit's ruling is affirmed, then Respondents will have the opportunity, on remand in the district court, to demonstrate that the taking also infringes upon their

First Amendment rights. If the Fifth Circuit's ruling is not affirmed, then Respondents should have the opportunity, for the reasons discussed below, to establish that the IOLTA programs violate their First Amendment rights.

II. THE COURT SHOULD REJECT THE SUGGESTION OF ONE OF THE *AMICI* SUPPORTING PETITIONERS THAT THE COURT SHOULD RULE AGAINST RESPONDENTS' FIRST AMENDMENT CLAIMS.

The Court limited the issue to be decided in this case to the question whether Respondents have a property interest in the interest earned on funds placed in IOLTA programs. However, the American Association of Retired Persons and the Legal Counsel for the Elderly filed an *amici curiae* brief in support of Petitioners urging this Court to consider and reject the First Amendment claims of Respondents. For the reason discussed below, this Court should reject the position of the *amici* American Association of Retired Persons and the Legal Counsel for the Elderly.

The Court may decide that Respondents do not have sufficient property interest to establish a claim under the Fifth Amendment. In doing so, the Court might, however, find that Respondents have some property interest in the beneficial use of the funds placed into the IOLTA, or some property interest in the funds generated by those accounts. While those rights may be insufficient under the facts of this case to make a claim under the Fifth Amendment, that does not preclude Respondents from making a claim under the First Amendment. Therefore, even if, *arguendo*, this Court rules that there is no taking of property in violation of Respondents' Fifth Amendment rights, the Court should not reject Respondents' First Amendment claims. The Respondents' First Amendment challenge to the IOLTA programs stands independent of the Fifth Amendment claim.

III. THIS CASE INVOLVES SIGNIFICANT FIRST AMENDMENT ISSUES THAT SHOULD NOT BE TAKEN UP UNTIL FURTHER BRIEFING.

The funds generated by the IOLTA programs in general, and the Texas IOLTA program in particular, are often used for ideological purposes. The funds generated in the IOLTA in Texas are initially transferred to the Texas Equal Access Justice Foundation ("TEAJF"). The TEAJF then distributes the funds to various private organizations that provide legal services. Funds generated by the IOLTA are used by the various recipient organizations in Texas to provide legal aid to refugees and to assist death row inmates challenging their death sentences. *Washington Legal Foundation v. Texas Equal Access*, 94 F.3d 996, 999 (1996). Each of those activities has an ideological component.

Money generated by funds in the IOLTA and turned over to private organizations is often used for political and ideological purposes. See Rounds, *Social Investing, IOLTA, and The Law of Trusts: The Settlor's Case Against the Political Use of Charitable and Client Funds*, 22 Loy. U. Chi. L.J. 163, 178-81 (1990).

Furthermore, legal service organizations are frequent recipients of IOLTA funds. The use of IOLTA funds by legal service organizations has been a heated political issue. See *In re The Matter of Public Law No. 1541990*, 561 N.E.2d 791, 795 (Ind. 1990) (Pivarnick, concurring) (discussing political and ideological activities engaged in by legal service organizations); 38 Cong. Rec. H65, at 3129-34 (daily ed. May 12, 1992) (debate and vote on whether Congress should prohibit Legal Services Corporation grantees from using IOLTA funds on venous political and ideological activities).

Activities engaged in by the recipients of IOLTA generated funds have significant communicative content because discussion of governmental affairs is at the core of First Amendment freedoms. *Lehnert*, 500 U.S. at 522; *Buckley v.*

Valeo, 424 U.S. at 1, 14 (1976); *Roth v. United States*, 354 U.S. 476, 484 (1957).

In addition to the impact such ideological activities have upon First Amendment rights of involuntary participants of IOLTA programs, the funding of litigation itself has First Amendment implications. In the context of a case dealing with compulsory union fees, this Court has held that litigation is not chargeable to objecting non-member fee payors unless it is directly related to collective bargaining or contract administration for the non-member's bargaining unit. *Ellis*, 466 U.S. at 453.

As this Court stated in another case involving the use of compulsory union dues:

We long have recognized the important political and expressive nature of litigation. See *e.g. NAACP v. Button*, 371 U.S. 415, 431, 83 S.Ct. 328, 337, 9 L.Ed.2d 405 (1963) (recognizing that for certain groups "association for litigation may be the most effective form of political association"). Moreover, union litigation may cover a diverse range of areas from bankruptcy proceedings to employment discrimination. See *Ellis*, 466 U.S., at 453, 104 S.Ct., at 1894. When unrelated to an objecting employee's unit, such activities are not germane to the union's duties as exclusive bargaining representative. Just as the Court in *Ellis* determined that the RLA, as informed by the First Amendment, prohibits the use of dissenters' fees for extraunit litigation, *ibid.*, we hold that the Amendment proscribes such assessments in the public sector.

Lehnert, 500 U.S. at 528.

So also in this case, the expressive nature of the litigation, especially political and ideological litigation engaged in by

organizations that receive IOLTA funds, implicates the First Amendment rights of the Petitioners.

The amount of money that the involuntary user of an IOLTA program has a property interest in is irrelevant. As this Court has held:

The amount at stake for each individual dissenter does not diminish this concern. For, whatever the amount, the quality of respondents' interest in not being compelled to subsidize the propagation of political or ideological views that they oppose is clear.

Hudson, 475 U.S. at 305.

As James Madison wrote, "Who does not see...(t)hat the same authority which can force a citizen to contribute three pence only of his property for the support of any one establishment, may force him to conform to any other establishment in all cases whatsoever?" 2 *The Writings of James Madison* 186 (Hunt ed. 1901).

Similarly, the fact that the use of the money that generates IOLTA funds is only temporary is not relevant. This Court has condemned on several occasions even the temporary use of compulsory union fees and compulsory Bar dues for political and ideological purposes. *Hudson*, 475 U.S. at 304-06; *Ellis*, 466 U.S. at 444.

Even if, *arguendo*, the taking of the interest earned on the funds held in the IOLTA does not amount to an unconstitutional taking, the involuntary users of the IOLTA may still have an objection that the money held in the trust account is used to generate interest for causes with which they disagree. The participants in IOLTA programs are forced to choose between refraining from exercising a civil right—the use of the courts—or supporting political and ideological causes with which they disagree.

When the state forces an individual to financially support a private organization (such as the IOLTA recipients) as a condition of exercising a legal right, it is "a significant impingement on First Amendment rights." *Ellis*, 466 U.S. at 455. Accordingly, traditional First Amendment analysis must be applied to this case to determine if the infringement can withstand constitutional scrutiny.

If, *arguendo*, the Court finds that Respondents have some property interest in the funds deposited into the IOLTA but that the property interest is insufficient to make the taking of the interest earned on that property an unconstitutional taking, then the Court should refrain from making any pronouncements concerning Respondents' First Amendment claims.

CONCLUSION

If this Court does not affirm the Fifth Circuit's holding that Respondents have a property interest in the funds held in the IOLTA, then it should refrain from deciding the important First Amendment issues raised by this case until the issue is squarely before this Court.

Respectfully submitted,

John C. Scully
National Right to Work Legal
Defense Foundation, Inc.
8001 Braddock Road
Springfield, VA 22160
(703) 321-8510

Attorney for *Amicus Curiae*
National Right to Work Legal
Defense Foundation, Inc.

October, 1997

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Supreme Court, U.S.

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No. 96-1578

**In The
Supreme Court of the United States
October Term, 1996**

HON. THOMAS R. PHILLIPS, et al.,
Petitioners,

vs.

WASHINGTON LEGAL FOUNDATION, et al.,
Respondents.

**On Writ of Certiorari to the
United States Court of Appeals For The Fifth Circuit**

**BRIEF OF
DEFENDERS OF PROPERTY RIGHTS*
AMERICAN ASSOCIATION FOR SMALL
PROPERTY OWNERSHIP
AS AMICI CURIAE IN SUPPORT OF RESPONDENTS**

Nancie G. Marzulla**
Christopher J. Oberst
**DEFENDERS OF
PROPERTY RIGHTS**
6235 33rd St. NW
Washington, DC 20015-2405
(202) 686-4197

October 10, 1997

*Amici listing continued on next page

**Counsel of Record

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[CONTINUED FROM COVER]

BRIEF *AMICI CURIAE* OF

**APARTMENT ASSOCIATION OF SOUTHEASTERN
WISCONSIN, INC.**

BOSTON PROPERTY EQUITY RIGHTS, INC.

CASSANDRA CHRONES MOORE

**NATIONAL ASSOCIATION OF REVERSIONARY
PROPERTY OWNERS**

**NEW HAMPSHIRE PROPERTY OWNERS'
ASSOCIATION**

**OHIO REAL ESTATE INVESTORS ASSOCIATION
CLIFFORD F. THIES, PH.D**

**WESTERN PENNSYLVANIA REAL ESTATE
INVESTORS ASSOCIATION**

QUESTION PRESENTED FOR REVIEW

Is interest earned on client trust funds held in IOLTA accounts a property interest of the client, cognizable under the Fifth Amendment to the United States Constitution?

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Pursuant to Rule 37.3 of the Rules of this Court, *amici curiae* submit this brief in support of Respondents.¹ Both parties have consented to the filing of this brief.

IDENTITY AND INTEREST OF *AMICUS CURIAE*

Defenders of Property Rights is the only national legal defense foundation devoted exclusively to protecting private property rights. Defenders was founded as a non-profit, public interest firm in 1991. Its mission is to protect vigorously those rights considered essential by the Framers of the Constitution, and to promote a better understanding of the relationship between private property rights and individual rights and liberty. Defenders of Property Rights engages in litigation across the country on behalf of its members to prevent government incursion into protections guaranteed by the Bill of Rights. Defenders devotes a significant portion of its resources to litigation and has participated in *Lucas v. South Carolina Coastal Council*, *Dolan v. City of Tigard*, *Babbitt v. Sweet Home Chapter Communities for a Great Oregon*, *Bennett v. Spear*, *Suitum v.*

¹No counsel for either party authored this brief *amici curiae*, either in whole or in part. Furthermore, no persons other than *amici curiae* (their members or counsel) contributed financially to the preparation of this brief.

Tahoe Regional Planning Agency and *Boerne v. Flores* when they were before this Court.

American Association for Small Property Ownership (Front Royal, VA), **Apartment Association of Southeastern Wisconsin, Inc.** (Milwaukee, WI), **New Hampshire Property Owners' Association** (Nashua, NH), **Ohio Real Estate Investors Association** (Cincinnati, OH), **Western Pennsylvania Real Estate Investors Association** (Pittsburgh, PA), and **Boston Property Equity Rights, Inc.** (Boston, MA) represent the interests of landlords property owners and real estate investors. Their collective goal is to restore common sense and equity to federal, state and local regulations, tax and liability and other laws that unconstitutionally impinge on the right of landlords, property owners and real estate investors to build wealth and success by the beneficial and productive use of property.

National Association of Reversionary Property Owners (Issaquah, WA) is nonprofit foundation whose major goal is to assist property owners in maintaining all ownership interests in land and to avoid the uncompensated confiscation of private property rights.

Cassandra Chrones Moore (Palo Alto, CA) is principal of CCM Associates. A property owner, consultant, realtor and public policy specialist, Ms. Moore is an adjunct scholar at the Competitive Enterprise Institute and the Cato Institute in

Washington, D.C. Her book, "Haunted Housing: How Toxic Scare Stories are Spooking the Public Out of House and Home," was published by Cato. She is a member of the Board of Directors of the American Association for Small Property Ownership which publishes "The Small Property Owner."

Clifford F. Thies, Ph.D (Winchester, VA) is the Durell Professor of Money, Banking and Finance at Shenandoah University. Formerly, he was named the Black & Decker Research Professor at the University of Baltimore, and in 1992, was a Bradley Resident Scholar at the University of Baltimore. The author and editor of four books and dozens of articles in scholarly journals and popular magazines, Dr. Thies is a member of the Board of Directors of the American Association for Small Property Ownership.

STATEMENT OF THE CASE

This case involves the taking by the state of Texas of interest earned on client fees paid to attorneys. Because attorneys often hold money for their clients, such as retainer fees or closing costs for a transaction, in escrow, the amount of money earned as interest in any given year is enormous. For example, the Texas IOLTA program alone has generated as much as \$10 million per year in recent years. Pet. App. at 5a.

Until 1980, federal law prohibited banks from paying interest on demand accounts. As a result, these client escrow accounts formerly amounted to interest-free loans to the banks because the banks could keep any income generated by the accounts.

In 1980, new banking regulations allowed "negotiable order of withdrawal" (NOW) accounts, which operate as interest-bearing checking accounts. Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C.A. § 1832 (West, 1989). These accounts created a vehicle for attorneys to pool client funds into an interest-bearing trust account, as long as none of the funds belonged to a for-profit corporation.

As a result of the availability of interest-bearing demand accounts, forty-nine states and the District of Columbia adopted Interest On Lawyers Trust Accounts (IOLTA) programs, which clustered individual client funds of nominal amounts into larger accounts where the accruing interest goes to the states, rather than the clients or the depository banks. The aggregate interest was then collected by the states and dispensed to groups deemed "public interests" by the states.

SUMMARY OF ARGUMENT

In 1980, this Court held that state governments violate the Just Compensation Clause of the Fifth Amendment when they fail to pay accrued interest on private funds held by state courts in interpleader accounts. *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980). The Court, in holding that interest generated from privately owned funds is itself private property, indicated that "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Id.* at 164. The Court then went on to hold that "a State, by *ipse dixit*, may not transform private property into public property without compensation, even for the limited duration of the deposit in court." *Id.*

Webb's Fabulous Pharmacies is squarely on point with the instant case. In IOLTA accounts, private financial institutions hold and invest the funds of private individuals in return for a payment of interest. IOLTA accounts are only different from other types of interest-bearing accounts because state governments are appropriating the interest payments that properly belong to either the client or the financial institution. State governments, therefore, under the holding of *Webb's Fabulous Pharmacies*, are "taking"

private property without just compensation in violation of the Fifth Amendment.

Other decisions of this Court, including *Board of Regents v. Roth*, 408 U.S. 564 (1972), do not affect this analysis. In *Roth*, a government employee brought a challenge pursuant to the Free Speech Clause of the First Amendment and the Due Process Clause of the Fourteenth Amendment of the failure of the State of Wisconsin to renew his one-year employment contract. *Id.* at 566-68. This Court held that the employee had no protected property at stake because he could not have a “reasonable expectation” in continued employment by the state after the expiration of his one-year contract. *Id.* at 578.

Nothing in this Court’s holding in *Roth* affects the issue of whether a client has property rights in interest generated from his IOLTA trust funds. Interest, unlike government benefits, is a tangible commodity that becomes the property of the owner of the principal, based on long-standing decisions of this Court and numerous state courts. Whether or not the owner of funds in a depository account has a “reasonable expectation” that his account will generate interest, any interest that actually accrues will still attach as a property right incident to his ownership of the underlying principal.

In short, IOLTA interest is private property that state governments may not simply take for their own use without violating the Fifth Amendment, regardless of the purpose for which the money is taken.

ARGUMENT

I. INTEREST EARNED ON CLIENT TRUST FUND ACCOUNTS CONSTITUTES PRIVATE PROPERTY UNDER CLEARLY ESTABLISHED LAW.

In their briefs before this Court, Petitioners and *amici curiae* supporting Petitioners attempt, at great length, to demonstrate that the interest generated by clients funds in IOLTA accounts is a form of public property “created” by the government. Br. of United States at 9. As the court below suggested, Petitioners apparently believe that:

The IOLTA program represents a successful, modern-day attempt at alchemy. . . . modern society generally scoffs at this attempt to create “something from nothing.” The defendants in this case denounce such skepticism, declaring that they have unlocked the magic that eluded the alchemists. The alchemists failed because the necessary ingredients for their magic did not exist in historical times: the combination of attorney’s

client funds and anomalies in modern banking regulations.

Pet App. at 7a. These arguments, however, simply fail to support the claim that IOLTA interest should be treated as any anything other than the private property of the owners of the underlying principal funds.

A. Interest On IOLTA Funds Is No Different Than Any Other Type Of Interest Generated From Private Funds.

It is undisputed that IOLTA programs generate a tremendous amount of interest from client trust funds.² Petitioners, however, attempt to show that IOLTA interest is somehow different than normal interest and, as such, is not the property of the owner of the underlying principal. In fact, Petitioners cannot make such a showing because IOLTA interest is created in exactly the same way as any other form of interest.

In the broadest terms, "interest is the rental price of money." *Wilshire Holding Corp. v. C.I.R.*, 262 F.2d 51, 53 (9th Cir. 1958). Other courts have defined interest in terms of

² Petitioners concede that IOLTA programs nationwide raise approximately \$100 million per year. Pet. Br. at 3.

compensation: "Interest is compensation paid for the use of money." *Western Plains Service Corp. v. Ponderosa Develop. Corp.*, 769 F.2d 654, 657 (10th Cir. 1985) *see also* *Miller v. Robertson*, 266 U.S. 243, 257 (1924) ("One who has had the use of money owing to another justly may be required to pay interest from the time the payment should have been made."). The definition of interest, therefore, emphasizes the concept of remuneration to the owner of money in return for temporarily giving up the custody and use of the money. Essentially, a depository institution takes possession of another's money to be invested in return for a "rental" payment to the owner of the money.

Despite the assertions from Petitioners that IOLTA interest is somehow "created" by the government, IOLTA interest is generated in exactly the same way as normal interest. In other words, private financial institutions invest money owned by private individuals in return for a payment of interest. The difference with IOLTA accounts is simply in the end result: state governments step in and take the "rental value" of the money rather than the owner of the money or his assigns. But in no sense can governments claim that they "create" this money—they neither provide the principal funds nor take the investment risks necessary to generate IOLTA interest money. Therefore, the government must, of

necessity, be “taking” IOLTA interest from someone, either the client or the bank holding the client’s principal funds.

B. Background Principles of State Law And Prior Decisions Of This Court Demonstrate Conclusively That Ownership Of Interest Follows Ownership Of The Underlying Principal.

Petitioners advance an additional theory as to why IOLTA interest belongs to state governments: that there is no absolute legal rule that ownership of interest follows principal. This argument, however, appears to give short shrift to previous decisions of this Court and to long-standing background principles of state law that hold exactly the opposite.

The court below relied upon this Court’s opinion in *Webb’s Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) in holding that ownership of IOLTA interest follows ownership of the underlying principal. In *Webb’s Fabulous Pharmacies*, the plaintiff entered into an agreement to purchase the assets of a corporation that was heavily in debt. *Id.* at 156. To protect its interests, the plaintiff filed a complaint of interpleader in state court naming as defendants both the corporation and its creditors. *Id.* at 156-57. Under state law, the plaintiff was required to deposit the amount of the agreed purchase price into an interpleader account in the

court’s registry. *Id.* at 157. After satisfying the claims of various creditors and withdrawing court fees, the clerk then returned the remainder of the interpleader account, but failed to pay the interest that the account had earned while in the possession of the court. *Id.* at 158. Plaintiff then filed a separate lawsuit against the state court clerk to recoup the interest generated on the interpleader fund.

This Court held that the withholding by the state court of payment of the interest on the interpleader fund was a “taking” of private property in violation of the Fifth Amendment. *Id.* at 165. In so holding, the Court noted that:

Seminole County has not merely ‘adjust[ed] the benefits and burdens of economic life to promote the common good’. . . . Rather the exaction is a forced contribution to general governmental revenues, and it is not reasonably related to the costs of using the courts.

Id. at 163(citations omitted).

The applicability of this Court’s opinion in *Webb’s Fabulous Pharmacies* to the present case could not be clearer. Clients whose funds are placed into IOLTA accounts are put in the position of making a “forced contribution” to state governments of any interest earned on their funds while they are held in the attorney’s trust account.

Indeed, the legal analysis applied by this Court in *Webb's Fabulous Pharmacies* is equally applicable to the present case. The actions of the government in *Webb's Fabulous Pharmacies* were characterized by this Court as analogous to the physical appropriation of private property found in *United States v. Causby*. *Webb's Fabulous Pharmacies*, 449 U.S. at 164 (citing *United States v. Causby*, 328 U.S. 256 (1946)). In *Causby*, the federal government was held to have appropriated the airspace above private property for the flight pattern of military aircraft. *Causby*, 328 U.S. at 262. The Court, as a result, has applied to the issue of property rights in interest payments the reasoning from the line of cases concerned with physical invasions of private property.

This is an apt analogy in the present case, for, as indicated above, the government has, by legislative or judicial fiat, inserted itself as the "third party beneficiary" of the contract between the attorney, his client, and the depository bank holding the client's trust funds. See *Peoples Westchester Sav. Bank v. FDIC*, 961 F.2d 327, 331 (2d Cir. 1992)(comparing government's position in New York IOLA program to that of third party beneficiary). The government is, to put it plainly, confiscating money that, in fairness and conformity with legal precedent, should belong to either the client that provides the principal or the financial institution

that takes the risk of investing the principal to create the interest.

Faced with such unfavorable precedent from this Court, it is understandable that Petitioners argue that the reasoning in *Webb's Fabulous Pharmacies* may only be applied to the specific factual situation of that case. But this assertion by Petitioners is simply untrue. This Court has cited *Webb's Fabulous Pharmacies* as authority on numerous occasions in cases far more factually distinct than the present case.³

Even if this Court, however, were to hold that the reasoning of *Webb's Fabulous Pharmacies* is relevant only to its own facts, the general principle that ownership of interest accrues to whoever has ownership of the underlying principal funds has deep roots in this country's legal history.

This Court has long supported the proposition that interest follows principal in opinions dating all the way back to the early days of the Republic. *Himely v. Rose*, 9 U.S. (5 Cranch) 313, 318 (1809)("interest goes with the principal, as

³ See, e.g., *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1031 (1992)(challenging denial of building permit for dwelling on beachfront); *Preseault v. I.C.C.*, 494 U.S. 1, 20 (1990)(O'Connor, J., concurring)(Rails To Trails Act challenged on Fifth Amendment grounds); and *United States v. Sperry Co.*, 493 U.S. 52, 62 (1990)(challenging government deduction of fees from settlement of private claims against Iranian government).

the fruit with the tree.”). Indeed, prior decisions of numerous state courts also support this basic rule of American jurisprudence.⁴

Petitioners, apparently realizing the lack of a legal or factual distinction between IOLTA interest and other types of interest, attempt to obfuscate this reality and focus the inquiry of this Court on the “expectations” of the clients whose money is being steered into IOLTA accounts. Petitioners’ argument can be summarized as follows: A person who does not have a ‘reasonable expectation’ of receiving a return on the investment of their funds cannot claim a property right to any return that is, in fact, generated. This argument cannot be supported by prior decisions of this Court.

⁴ See, e.g., *City of Seattle v. King County*, 762 P.2d 1152, 1155 (Wash. App. 1988)(“The judgment in the instant case is supported by the common law principle that interest on public funds follows the ownership of those funds”); *Thompson v. Gasparro*, 257 N.W.2d 355, 356 (Minn. 1977)(“It is a general rule that interest is an integral part of the debt and a claim for it must stand or fall with the principal debt”); *Liquidation of Canal Bank & Trust Co.*, 30 So. 2d 841, 852 (La. 1947)(“... interest is a mere incident to the principal debt”); *In re Beckman*, 14 A.2d 581, 583 (Pa. Super. 1940)(“The rule is that the principal of a claim cannot be placed on a different footing from the interest accruing thereon”); *Des Moines Mut. Hail & Cyclone Ins. Ass’n v. Steen*, 175 N.W. 195 (N.D. 1919)(“Now it is manifest that the accruing interest follows the principal ...”).

Petitioners base this argument on their interpretation of this Court’s opinion in *Board of Regents v. Roth*, 408 U.S. 564 (1972). In *Roth*, the Court held:

[t]o have a property interest *in a benefit*, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.

Id. at 577 (emphasis added). The plaintiff in *Roth* brought suit regarding the non-renewal of his employment contract by the state of Wisconsin. *Id.* at 568. This Court held that the plaintiff had no property interest in a contract renewal, since he had no reasonable expectation that it would be renewed. *Id.* at 578.

Roth, however, is inapposite to the present case. The “property” at issue in *Roth* was characterized as a government benefit, and the language of the Court’s opinion explicitly limits the “reasonable expectation” requirement to this intangible and ephemeral form of “property.” In the present case, the application of this standard would be ridiculous because the IOLTA interest exists as a tangible commodity, regardless of the expectations of the owner of the principal funds. In such a case, to hinge property

ownership on the existence of an appropriate level of "expectation" makes no sense.

Indeed, the existence of a property right without a reasonable expectation thereof is hardly unique to this case. Numerous instances can be shown where property owners can claim a right to property that they had no 'reasonable expectation' of receiving. One example is the purchaser of a lottery ticket. Given the extremely high odds against winning the grand prize in a lottery, the holder of a lottery ticket could hardly have a 'reasonable expectation' that they will become the grand prize winner. Nevertheless, the ticket holder who does ultimately win the grand prize has an undoubted property interest in the lottery proceeds.

Finally, in the context of normal private individual deposit accounts, a depositor might well open an account consisting of such a small amount of money that they do not expect to receive interest. But if a single penny of interest is earned on their funds, that penny does not magically belong to someone else, merely because the account holder did not expect his account to earn that penny in interest.

Quite simply, the law is clear that the owner of deposited funds has a property right to interest generated from that money, no matter what the mindset of the owner may be. There is no legally cognizable basis for state

governments to assert that a client has no property rights to interest generated from his trust funds.

II. GOVERNMENTS MAY NOT CIRCUMVENT THEIR CONSTITUTIONAL OBLIGATIONS BY ATTEMPTING TO "REDEFINE" PRIVATE PROPERTY INTO PUBLIC PROPERTY, NO MATTER HOW MERITORIOUS THEIR OBJECTIVE MAY BE.

Lacking any sound legal foundation for their assertion that clients do not have property rights in interest generated off of their IOLTA funds, Petitioners ultimately fall back on the argument that the ends justify the means: "By challenging IOLTA, Respondents attack the programs that provide many of America's elderly, its homeless, its sick, and its poor access to our justice system." Pet. Br. at 36.

In the American scheme of constitutional law, however, the ends do not justify the means when individual rights are undermined. As this Court said in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922): "We are in danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." *Id.* at 416.

Moreover, this Court should not be misled by Petitioners' attempts to minimize the impact on clients of the

government appropriation of IOLTA interest. This court has previously indicated that even *de minimus* invasions of private property are to be treated as a violation of the Fifth Amendment. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435-36 (1982).

IOLTA programs are nothing less than an attempt to convert private property into public property under the cover of banking regulations. Whatever the purpose IOLTA programs are intended to serve, this conversion is a blatant attempt to circumvent the limitations of the Fifth Amendment. The continued existence of IOLTA programs represents a threat to the very concept of private property in this country, as it gives a signal to governments that they may appropriate private property through the simple process of "redefining" it as public property.

CONCLUSION

For all of the foregoing reasons, *amici curiae* urge this Court to uphold the decision below.

Respectfully submitted,

Nancie G. Marzulla
Christopher J. Oberst
DEFENDERS OF
PROPERTY RIGHTS
6235 33rd Street, N.W.
Washington, DC 20015
202-686-4197

October 10, 1997

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In The

Supreme Court of the United States

October Term, 1997

Hon. Thomas R. Phillips, Hon. Raul A. Gonzalez, Hon. Jack Hightower,
Hon. Nathan L. Hecht, Hon. Lloyd Doggett, Hon. John Cornyn, Hon.
Bob Gammage, Hon. Craig T. Enoch, Hon Rose Spector, Texas Equal
Access to Justice Foundation, and W. Frank Newton, in his Official
Capacity as Chairman of the Texas Equal Access to Justice Foundation,
Petitioners

v.

Washington Legal Foundation, William R. Summers, and Michael J.
Mazzone,
Respondents

*On Petition for Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit*

Motion for Leave to File Amicus Brief

Henry C. Dinger, P.C.
GOODWIN, PROCTER & HOAR LLP
Exchange Place
Boston, Massachusetts 02109
(617) 570-1000

Counsel for the Massachusetts Bar
Foundation, amicus curiae

4 PP

The Massachusetts Bar Foundation ("MBF") moves this Court for leave, *nunc pro tunc*, to file an amicus brief in support of petitioners. MBF filed an amicus brief on August 25, 1997, pursuant to Supreme Court Rule 37.3, on the understanding that both petitioners and respondents had consented to that filing. Counsel for MBF had obtained the consent of the counsel of record for both petitioners and respondents. MBF's counsel was subsequently advised by respondent Michael J. Mazzone, a respondent representing himself *pro se* in this case, that he did not consent to MBF's submission of an amicus brief in support of petitioners. The only reason that Mr. Mazzone gave for his refusal to consent was that MBF had earlier declined to consent to his filing an amicus brief in another case.

Reasons for Granting Leave to File Amicus Brief

The instant case presents the issue whether the Texas Interest on Lawyers' Trust Accounts ("IOLTA") program constitutes an unconstitutional taking of property in violation of the Fifth and Fourteenth Amendments to the Constitution. MBF, and the non-profit organizations in Massachusetts that MBF supports, have a vital interest in the resolution of this issue.

The MBF is a charitable corporation established in 1964 as the charitable arm of the Massachusetts Bar Association, the principal statewide organization of lawyers practicing in the Commonwealth of Massachusetts.

In 1985, the Massachusetts Supreme Judicial Court established an IOLTA program in Massachusetts that permitted lawyers to pool short-term and nominal client funds entrusted to their custody into interest-bearing accounts with the interest payable to certain organizations, including MBF, that fund legal services for indigents and programs for improving the administration of justice. *See generally* *Petition of Massachusetts Bar Association*, 395 Mass. 1, 478 N.E.2d

715 (1985). The Court later required all Massachusetts lawyers to use IOLTA accounts for such client funds.

MBF currently is responsible for allocating approximately one-quarter of the funds raised by the Massachusetts IOLTA program, nearly \$2 million in 1996. In Massachusetts, IOLTA funds not only traditional legal services programs for the benefit of people unable to afford representation (in divorce cases, landlord-tenant disputes, and the like) but also programs designed to enhance the administration of justice. Recent grant recipients have included several mediation and other alternative dispute resolution programs that have the effect of reducing congestion in Massachusetts courts, as well as programs providing coordination and support for "lawyer for a day" and other pro bono projects that assist pro se litigants and other unrepresented persons. The Flaschner Judicial Institute, an organization dedicated to providing continuing education programs for judges in Massachusetts, receives a significant portion of its funding from the Massachusetts IOLTA program.

In 1991, respondent, Washington Legal Foundation, and several individuals brought suit in the United States District Court for the District of Massachusetts against the Supreme Judicial Court, the MBF and other parties involved in the Massachusetts IOLTA program challenging the constitutionality of that program on grounds essentially identical to those raised here. The First Circuit affirmed the dismissal of those claims, finding that the IOLTA program neither took the property of Massachusetts lawyers or their clients in violation of the Fifth Amendment, nor infringed their rights under the First Amendment. *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962 (1st Cir. 1993).

MBF has a direct interest in this case because the Texas IOLTA program in many respects is similar to the Massachusetts program and a decision by this Court upholding the Fifth Circuit's conclusion that the former is unconstitutional may pose a direct threat to the Massachusetts program.

If the Massachusetts IOLTA program is invalidated in its current compulsory form, the resources available to advance the common goals of MBF and the IOLTA program will be dramatically reduced. It was for this reason that MBF submitted an amicus brief in the Fifth Circuit in this case, and now seeks to do so before this Court.

MBF shares with this Court a passionate commitment to "equal justice under law," as well as a deep concern for improving the administration of justice in state and federal court systems. In this age of diminished public funding of legal services and the judiciary, the IOLTA program is an essential part of achieving these goals.

Conclusion

For the foregoing reasons, MBF asks that this Court grant leave, *nunc pro tunc*, for the submission of its amicus brief filed on August 25, 1997.

Respectfully submitted,

Henry C. Dinger, P.C.
GOODWIN, PROCTER & HOAR LLP
Exchange Place
Boston, MA 02109
(617) 570-1000

*Counsel for the Massachusetts Bar
Foundation, amicus curiae*

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, *et al.*,
Petitioners,
v.
WASHINGTON LEGAL FOUNDATION, *et al.*,
Respondents.

On Writ of Certiorari to the
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BRIEF OF THE COUNCIL OF STATE GOVERNMENTS,
NATIONAL ASSOCIATION OF COUNTIES,
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INTERNATIONAL MUNICIPAL
LAWYERS ASSOCIATION AND
U.S. CONFERENCE OF MAYORS
AS *AMICI CURIAE* SUPPORTING PETITIONERS

DAVID B. ISBELL
ROBERT A. LONG, JR.
CAROLINE M. BROWN
COVINGTON & BURLING
P.O. Box 7566
1201 Pennsylvania Ave., N.W.
Washington, D.C. 20044
(202) 662-6000

RICHARD RUDA *
Chief Counsel
STATE AND LOCAL
LEGAL CENTER
Suite 345
444 North Capitol St., N.W.
Washington, D.C. 20001
(202) 434-4850

* Counsel of Record for the
Amici Curiae

QUESTION PRESENTED

Is interest earned on client trust funds held by lawyers in IOLTA accounts a compensable property interest of the client or lawyer, cognizable under the Fifth Amendment of the United States Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could not earn interest for the client or lawyer?

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IN THE
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OCTOBER TERM, 1996

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BRIEF OF THE COUNCIL OF STATE GOVERNMENTS,
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INTERNATIONAL MUNICIPAL
LAWYERS ASSOCIATION AND
U.S. CONFERENCE OF MAYORS
AS *AMICI CURIAE* SUPPORTING PETITIONERS

Pursuant to Rule 37.6, *amici* state that no counsel for a party has authored this brief in whole or in part, and that no person or entity, other than the *amici*, their members, or their counsel, has made a monetary contribution to the preparation or submission of this brief.

INTEREST OF THE *AMICI CURIAE*

Amici, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling interest in legal issues that affect state and local governments. *Amici* have both a specific and general interest in the issue presented in this case.

Amici have a specific interest in defending the constitutionality of Interest on Lawyers' Trust Account ("IOLTA") programs. These programs have been adopted by all 50 States (with one not yet operational) and the District of Columbia in the belief that such programs are constitutionally sound. IOLTA programs have become a critical source of financial support in providing legal services to the poor.

Amici also have a more general interest in the Fifth Amendment jurisprudence governing the taking of private property for public use. State and local governments are involved in eminent domain proceedings and land-use regulations that provide the basis for most "takings" claims. The question of what constitutes "property" and whether "just compensation" has been paid are thus important issues that affect the daily process of governing at the state and local levels.

Because of the importance of these issues to *amici* and their members, they submit this brief to assist the Court in its resolution of the case.¹

STATEMENT

1. In 1981, Florida became the first State to implement an IOLTA program, based on similar programs

¹ Letters from all parties consenting to the filing of this brief have been filed with the Clerk.

operating successfully in Canada, Australia, and elsewhere. See *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981); *Petition by Massachusetts Bar Ass'n*, 478 N.E.2d 715, 716-17 (Mass. 1985). Since 1981, the remaining 49 States and the District of Columbia have adopted such programs.² IOLTA programs generally have been adopted by order of the state supreme court, as an amendment to court rules or to rules of professional conduct.³ Five States have implemented their program by statute.⁴ The program is mandatory in 26 States; in the remainder the program is either voluntary or includes an opt-out provision. See ABA Comm'n on Interest on Lawyers' Trust Accounts, *IOLTA Update* 5 (Feb. 1996).

² The Indiana IOLTA program has been approved in principle but is not yet operational.

³ The IOLTA programs in the following States have been adopted by order of the highest court in the State: Alabama, Alaska, Arizona, Arkansas, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. In addition, the IOLTA program in the District of Columbia was promulgated by an order of the District of Columbia Court of Appeals. In seven States, the order establishing the IOLTA program was accompanied by formal opinion. See *infra* note 12.

⁴ See Cal. Bus. & Prof. Code § 6211 (West 1990); Conn. Gen. Stat. § 51-81c (1985); Md. Code Ann., Bus. Occ. & Prof. § 10-303(b) (1995); N.Y. Jud. Law § 497 (McKinney Supp. 1997); Ohio Rev. Code Ann. § 4705.09 (Anderson 1997). Pennsylvania's IOLTA program previously operated by statute, see Pa. Stat. Ann. tit. 62, § 4021 *et seq.* (West

While the details of these programs vary among jurisdictions, the basic operation of each is the same. The "fundamental precept" of the program (Pet. i) is that certain funds of clients held in trust by a lawyer cannot reasonably be expected to earn interest sufficient to offset the transaction costs that would be incurred in determining and disbursing the earned interest attributable to each client's funds. Under an IOLTA program, these funds—which generally are nominal in amount or held for a short period of time—are deposited by the lawyer into a common, interest-bearing demand account. The interest earned on the account is then remitted to the state bar or to a fund administered by the bar or other state entity, which uses the funds so received to fund a variety of legally-related public service programs.

Interest from IOLTA programs has become a critical source of funding for legal services to the poor. *See IOLTA Update* at 4. In 1994, of the \$91 million in total grants made by IOLTA programs, over \$85 million went to legal services. *Id.* Other general categories of grants include administration of justice, public legal education, law student scholarships and service activities, and indigent defense. *Id.*

Virtually all States require that funds eligible for IOLTA deposit be "nominal in amount" or held "for a short period of time" before they can be eligible for deposit in an IOLTA account. For some, this is the only statutory requirement.⁶ Several States, however,

1996), but the statute has been supplanted by a bar rule, *see* Pa. R. Prof. Conduct 1.15(d)(1); Pa. R. Disciplinary Enforcement R. 601(d).

⁶ *See, e.g.,* Ala. R. Prof. Conduct 1.15(f); Alaska R. Prof. Conduct 1.15(d); Cal. Bus. & Prof. Code § 6211(a) (West

make explicit the assumption that such funds will not generate interest in excess of fees and specify that IOLTA-deposited funds cannot reasonably be expected to earn a positive net return for the client.⁶ Many set out factors that a lawyer must consider in determining whether funds will generate sufficient interest income to justify the expense of administering a segregated account.⁷ Others set a minimum threshold

1990); Colo. R. Prof. Conduct 1.15(e)(2); D.C. Ct. App. R.X, Appendix B (a)(1); Ga. Code Prof. Responsibility DR 9-102(C)(2); Idaho R. Prof. Conduct 1.15(d); Kan. Sup. Ct. R. 226, R. Prof. Conduct 1.15(d)(3); Miss. R. Prof. Conduct 1.15(e); Mont. R. Prof. Conduct 1.15(e); Neb. Code Prof. Responsibility DR 9-102(C); Nev. S. Ct. R. 217; N.H. S. Ct. R. 50; N.C. R. Prof. Conduct Canon X, R. 10.3(a); Ohio Rev. Code Ann. § 4705.09(A)(2) (Anderson 1997); Okla. Stat. Ann. tit. 5, Ch. 1, App. 3-A, R. 1.15(d) (1996); R.I. R. Prof. Conduct 1.15(d); S.C. App. Ct. R. 412(a); S.D. R. Prof. Conduct 1.15(d)(3); Tenn. S.Ct. R. 8, Code Prof. Responsibility DR 9-102(C)(2); Vt. Code Prof. Responsibility DR 9-103(A); Wyo. R. Prof. Conduct 1.15, sec. II(a).

⁶ *See, e.g.,* Me. Code Prof. Responsibility 3.6(e)(3) & (7); Ky. S. Ct. R. 3.830(2)(A); Pa. R. Prof. Conduct 1.15(d)(1); Va. Code Prof. Responsibility DR 9-102(E)(1); Wash. R. Prof. Conduct 1.14(c)(3); W. Va. R. Prof. Conduct 1.15(d)(1); Wis. S. Ct. R. 20:1.15(c)(3); *cf.* Iowa Code Prof. Responsibility DR 9-102(C)(3) (funds not eligible for IOLTA deposit if they would produce a "significant positive net return").

⁷ For example, Massachusetts asks lawyers to consider "the amount of interest likely to be earned during the period the funds are expected to be deposited, as well as the estimated cost of establishing and administering a separate client fund account, including reasonably imputed overhead costs, and the estimated cost of preparing any tax or other reports required for interest accruing to a client's benefit." Mass. Sup. Jud. Ct. R., Sec. E, Guidelines for Interest on Lawyers' Trust Accounts, A(2)(b). *See also* Ariz. Sup. Ct. R. 44(c)(4);

of interest that must be earned, on the assumption that interest below such a threshold will not cover transaction costs of establishing a separate account.⁸ Finally, several state courts have interpreted their IOLTA rules against the background requirement that a lawyer who reasonably expects that client funds will yield enough interest to offset transaction costs is ethically obligated to make the funds produce income for the benefit of the client.⁹

2. The Texas IOLTA program at issue in this case is typical of IOLTA programs generally. The Supreme Court of Texas approved implementation of an IOLTA program after it found that "[o]n certain client funds held by attorneys, interest income cannot reasonably be earned to benefit individual clients for

Ark. R. Prof. Conduct 1.15(d) (5); Del. R. Prof. Conduct, Interpretative Guidelines No. 2(m); Fla. Bar R. 5-1.1(e) (7); Hawaii S. Ct. R. 11(C) (2) (F); Ill. R. Prof. Conduct 1.15(e); Minn. R. Prof. Conduct 1.15(f); Mo. S. Ct. R. 4, R. Prof. Conduct 1.15(d) (2); N.M. R. Prof. Conduct 16-115(F); N.Y. Jud. Law § 497(4) (b) (McKinney Supp. 1997); N.D. R. Prof. Conduct 1.15(d) (3); Or. Code Prof. Responsibility DR 9-101(D) (4).

⁸ See La. R. Prof. Conduct 1.15, IOLTA R. 3(d) (\$50 threshold); Md. Code Ann., Bus. Occ. & Prof. Code Ann. § 10-303(b) (1995) (\$50 threshold); Mich. R. Prof. Conduct 1.15(d) (\$50 threshold); N.J. Court R. 1:28A-2(b) (4) (\$150 threshold). Connecticut requires that the funds be "less than ten thousand dollars in amount or . . . held for a period of not more than sixty business days." Conn. Gen. Stat. § 51-81c(a) (1985).

⁹ See, e.g., *Massachusetts Bar Ass'n*, 478 N.E.2d at 718; *id.* at 719 (Nolan, J., concurring); *In re Interest on Lawyers' Trust Accounts*, 672 P.2d 406, 407 (Utah 1983); *In re Petition of Minnesota Bar Ass'n*, 332 N.W.2d 151, 157-58 (Minn. 1982); *In re New Hampshire Bar Ass'n*, 453 A.2d 1258, 1261 (N.H. 1982).

whom the funds are held." Pet. App. 56a. As in most States, these are defined as funds that "are nominal in amount or are reasonably anticipated to be held for a short period of time." *Id.* at 57a.

In Texas, funds are considered nominal in amount or held for a short period of time

if such funds, considered without regard to funds of other clients which may be held by the attorney . . . could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client.

Id. at 57a-58a.¹⁰ If a lawyer determines in good faith that he or she is holding funds that meet these criteria, the lawyer is instructed to deposit the funds in an IOLTA account, with interest to be transmitted quarterly to the Texas Equal Access to Justice Foundation. *Id.*

3. Alleging that the Texas IOLTA program violated their rights under the First and Fifth Amendments, respondents brought suit in U.S. District Court. The District Court granted summary judgment for petitioners on the ground that respondents had no constitutionally cognizable property interest at

¹⁰ Also to be considered are "the nature of the proceeding or transaction involved and the likelihood of delay in the need for such funds in such proceeding or transaction." Pet. App. 58a. Moreover, attorneys are instructed to review placement of the funds at reasonable intervals to determine whether changed circumstances would merit moving the funds to a separate account. *Id.*

stake because, in the absence of the IOLTA program, they could not earn interest on funds in IOLTA accounts. Pet. App. 20a-40a. The decision was consistent with decisions from the First and Eleventh Circuits¹¹ and the highest appellate courts of seven States.¹²

The Fifth Circuit reversed. Pet. App. 1a-19a. The court found a property interest despite the District Court's findings, which it did not dispute, that "the only funds eligible for deposit in an IOLTA account are those that have no reasonable possibility of legally generating net interest income benefiting the client" and that "under the IOLTA Rules, the principal amounts at issue cannot be reasonably expected to earn net interest on their own." *Id.* at 23a-24a, 27a n.7.

The Fifth Circuit reasoned that whether the interest on IOLTA funds constitutes "property" for purposes of the Fifth Amendment does not depend on the value of the interest to the owner of the principal

¹¹ See *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962, 975-76 (1st Cir. 1993); *Cone v. State Bar of Florida*, 819 F.2d 1002, 1007 (11th Cir.), *cert. denied*, 484 U.S. 917 (1987).

¹² See *Massachusetts Bar Ass'n*, 478 N.E.2d at 717-18; *In re Adoption of Amendments to C.P.R.D.R. 9-102 IOLTA*, 102 Wash. 2d 1101 (1984); *In re Interest on Lawyers' Trust Accounts*, 675 S.W.2d 355, 356-58 (Ark. 1984); *In re Interest on Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *New Hampshire Bar Ass'n*, 453 A.2d at 1261; *Minnesota Bar Ass'n*, 332 N.W.2d at 159; *Interest on Trust Accounts*, 402 So.2d at 396; see also *Carroll v. State Bar of California*, 213 Cal. Rptr. 305, 312 (Ct. App. 1984) (intermediate California appellate court decision upholding IOLTA program), *cert. denied*, 474 U.S. 848 (1985).

once transaction fees are deducted. Pet. App. 13a-14a. According to the Fifth Circuit, the courts that have upheld these programs have erroneously defined "property" as "an interest that must necessarily benefit its owner." *Id.* at 12a. The court found no such requirement in this Court's takings jurisprudence. In particular, the Fifth Circuit understood this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980), as having created a "rule" for defining property "that is independent of the amount or value of interest at issue." *Id.*

Thus, the court concluded, the fact that the interest earned on IOLTA accounts is valueless to the client (once fees are deducted) is irrelevant, because a Fifth Amendment property interest "attaches the moment that the interest accrues." *Id.* at 13a. Having reversed the District Court's determination that clients did not have a valid property interest in the interest proceeds on funds in IOLTA accounts, the Fifth Circuit remanded the case for reconsideration. *Id.* at 19a.

SUMMARY OF ARGUMENT

Amici agree with petitioners and their other supporting *amici* that interest generated from IOLTA funds is not "property" protected by the Fifth Amendment. *Amici* focus on an additional argument, based on just compensation principles, in support of petitioners. The Fifth Amendment does not proscribe the taking of private property for public use; it proscribes taking private property for public use "without just compensation." *Williamson County Reg. Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 194 (1985). Applying well-established principles, the

"just compensation" for a taking of the interest on IOLTA trust accounts is zero. For purposes of the Fifth Amendment, the value of property is determined by what "the owner [has] lost," not what "the taker [has] gained." *Boston Chamber of Commerce v. City of Boston*, 217 U.S. 189, 195 (1910). In the case of IOLTA programs, the "owner" of the putative "property" taken (i.e., the interest earned on the owned funds) has lost nothing, because the funds by definition are not reasonably expected to generate interest in excess of the transaction costs that would be incurred in determining and distributing the interest generated. Absent an IOLTA program, clients could not realize the "use value" of such funds, and banks and other financial institutions in which client funds are deposited would enjoy use of the funds. IOLTA programs transfer the use value of those client funds from financial institutions (which clearly lack a constitutionally-protected interest in the use value of the funds) to the government. That transfer is not compensable under the Fifth Amendment.

Where "nothing of value was taken," "[n]othing [is] recoverable as just compensation." *Marion & Rye Valley Ry. v. United States*, 270 U.S. 280, 282 (1926). To say that an interest is not compensable under the Fifth Amendment is another way of saying that it is not a constitutionally-protected property interest. In the case of interest earned on IOLTA funds, nothing of value is taken from the property owner. Consequently, interest on IOLTA accounts is not a compensable property interest under the Fifth Amendment.

ARGUMENT

THE TEXAS IOLTA PROGRAM DOES NOT TAKE A COMPENSABLE PROPERTY INTEREST

Amici agree with petitioners that the interest generated from IOLTA funds is not a constitutionally cognizable property interest. The fundamental precept of IOLTA is that the client's funds, absent the IOLTA program, could not earn interest for the client-owner in excess of the transaction costs of determining and disbursing earned interest, including any overhead and tax reporting costs. Prior to the adoption of IOLTA programs, clients entrusting their lawyers with funds to be held for a short period of time or funds nominal in amount received nothing back in excess of the initial principal. Following the adoption of IOLTA programs, the clients' financial position is unchanged. Respondents' argument that IOLTA simultaneously creates and takes away a constitutionally-protected property interest must be rejected.

Without disputing that the only funds eligible for deposit in an IOLTA account are those that have no reasonable possibility of generating net interest income benefitting the client, the Fifth Circuit found a property interest by applying a "two-part process" theory of accrued interest. Pet. App. 13a. The court held that a bank first pays interest on the account and then deducts fees, and that the "property interest attaches the moment that the interest accrues." *Id.*

Petitioners, and other *amici* supporting them, have demonstrated that this two-step approach is invalid, because there would be no first step absent IOLTA. Rather than repeat those arguments here, *amici* suggest an additional reason that the decision below

must be reversed. "The Fifth Amendment does not proscribe the taking of property; it proscribes taking without just compensation." *Williamson County Reg. Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 194 (1985) (citations omitted). In the case of IOLTA programs, "just compensation" means no compensation at all, because the programs are structured in such a way that nothing of monetary value to the owner is taken. Because IOLTA programs do not take a compensable interest in property, they do not violate the Fifth Amendment.

In some cases, the Court has found it possible to separate the question whether government action takes a compensable property interest from the amount of compensation that is constitutionally required. See, e.g., *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 441 (1982) (holding that a permanent physical occupation of real property is a taking, and remanding for a determination of the amount of compensation due). In this case, however, the two questions are not analytically distinct. "In the sense used in the Fifth Amendment, property refers to any interest recognized as property in the law and which requires compensation if acquired by the government through eminent domain." 2 Julius L. Sackman, *Nichols on Eminent Domain* § 5.01[2][b][i], at 5-9 (rev. 3d ed. 1997) (emphasis added). See also *id.* § 5.01[5][c], at 5-34 to 5-35 (interest is not "property" within the meaning of the Fifth Amendment unless it is "practicable to place a money value" on the interest) (footnote omitted). In *Williamson*, this Court recognized the connection between just compensation and the definition of compensable property interests by reaffirming that there is no violation of the Fifth Amendment until the government has de-

nied just compensation. 473 U.S. at 194-95 & n.13. See also *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 482 U.S. 304, 314 (1987); *Ruckelshaus v. Monsanto*, 467 U.S. 986, 1018 n.21 (1984).

As explained below, the structure of IOLTA programs is such that the interest earned and paid on IOLTA accounts has no monetary value to any individual owner of the pooled principal on which the interest is earned, and thus is not, as to any such owner, a compensable property interest cognizable under the Fifth Amendment. Accordingly, the Court's just compensation cases bear directly on whether interest on IOLTA accounts is a cognizable property interest under the Fifth Amendment.

A. Just Compensation Is Measured By The Property Owner's Loss, Not The Government's Gain

In 1910, Justice Oliver Wendell Holmes, speaking for a unanimous Court, said that in valuing property that has been taken by the government "the question is what has the owner lost, not what has the taker gained." *Boston Chamber of Commerce v. City of Boston*, 217 U.S. 189, 195 (1910). See also *id.* at 194 (government is not obligated to compensate a property owner "for a loss of theoretical creation, suffered by no one in fact"). Since that time, this Court has consistently upheld the rule that just compensation is determined by the loss to the property owner, not the gain to the government. See, e.g., *United States v. Virginia Elec. & Power Co.*, 365 U.S. 624, 633-36 (1961); *United States v. Pewee Coal Co.*, 341 U.S. 114, 121 (1951) (Reed, J., concurring); *Kimball Laundry Co. v. United States*, 338 U.S. 1, 13 (1949); *United States v. Causby*, 328 U.S. 256, 261 (1946).

In *Kimball Laundry*, the Court explained why just compensation must be based on the loss to the owner rather than the benefit to the taker: If farmland is taken by the government to be used as a firing range, the farmer loses his business as well as his land. By contrast, if the same farmer owned swamp land that was taken by the government to be used as a firing range, the farmer would have lost only his land. See 338 U.S. at 13. In both cases, the gain to the government—the firing range—is the same. The loss to the owner, however, differs dramatically. As the Court stated, “[i]f benefit to the taker were made the measure of compensation, it would be difficult to justify higher compensation for farm land taken as a firing range than for swamp or sandy waste equally suited to the purpose.” *Id.*

This valuation principle applies with equal force when the gain to the government is of greater value than the loss to the property owner, as would be the case here if interest on IOLTA funds were deemed protectable property. *Nortz v. United States*, 294 U.S. 317 (1935), is illustrative. *Nortz* involved gold certificates that had been issued by the federal government to individuals. The gold certificates operated like today’s savings bonds except that the certificates were redeemable for gold coin. The plaintiff, *Nortz*, owned gold certificates worth \$106,300 in currency, and \$170,634 in gold. See 294 U.S. at 323. Subsequent to *Nortz*’s purchase of the certificates, Congress enacted the Emergency Banking Act, requiring all holders of gold coin, gold bullion and gold certificates to deliver them to the Treasurer of the United States. *Id.* at 327. *Nortz* delivered his gold certificates and received \$106,300 in currency. *Nortz* filed suit, arguing that he did not receive just com-

pensation for the gold certificates taken by the government. He argued that had he been paid in gold coin, he would have received the cash equivalent of \$170,634 because of the increase in value of gold. *Id.* at 323-24, 329. The Court rejected *Nortz*’s argument, explaining that there was no free market for gold as a result of the Emergency Banking Act and other legislative measures prohibiting the trade and export of gold by anyone other than an authorized gold dealer. *Id.* at 329-30. Because *Nortz* was not an authorized dealer, the Court reasoned that he was entitled only to the value of the certificates in cash because he could not sell the gold on the open market. *Id.*

Applying these valuation principles, the value of interest on IOLTA account funds must be determined from the point of view of the owners of the pooled principal—the clients—and not the government.¹³ This involves ascertaining the fair market value of the property in the hands of each owner.

In *United States v. Miller*, 317 U.S. 369 (1943), this Court reaffirmed the rule that just compensation is established as the market value of the owner’s interest at the time of the taking. *Id.* at 374. Market value is usually defined as that which “a willing buyer would pay in cash to a willing seller.” *Id.*; accord *United States v. 564.54 Acres of Land*, 441 U.S. 506, 511 (1979); *Almota Farmers Elevator & Warehouse Co. v. United States*, 409 U.S. 470, 474 (1973);

¹³ Lawyers clearly lack a compensable property interest in interest earned on client trust funds. In Texas, as elsewhere, ethical rules prohibit lawyers from pooling client funds for the lawyer’s benefit. See *Tex. Disciplinary R. Prof. Conduct* 1.14.

Virginia Elec. & Power Co., 365 U.S. at 633; *United States v. Petty Motor Co.*, 327 U.S. 372, 377-78 (1946). Under the market value standard, "[t]he owner is to be put in the same position monetarily as he would have occupied if his property had not been taken." *United States v. Reynolds*, 397 U.S. 14, 16 (1970). See also *Olson v. United States*, 292 U.S. 246, 255 (1934) (owner "is entitled to be put in as good a position pecuniarily as if his property had not been taken," but "is not entitled to more").

The market value standard "is not an absolute standard nor an exclusive method of valuation." *Virginia Elec. & Power Co.*, 365 U.S. at 633; accord *United States v. Fuller*, 409 U.S. 488, 490 (1973). Courts have deviated from the market value standard in cases involving the loss of profits, damage to good will, expense of relocation, and other such consequential losses. But "[d]eviation from [the market value] measure of just compensation has been required only 'when the market value has been too difficult to find, or when its application would result in manifest injustice to owner or public.'" *United States v. 50 Acres of Land*, 469 U.S. 24, 29 (1984) (quoting *United States v. Commodities Trading Corp.*, 339 U.S. 121, 123 (1950)).

There is no reason to deviate from the market value standard in this case. Financial institutions engaged in the business of paying interest for the use of funds establish a market value for the use of money. Applying the market value standard works no injustice on clients, who could not realize any interest on the funds in the absence of an IOLTA program. Indeed, awarding compensation under a non-market value standard would amount to awarding clients a windfall.

B. Just Compensation Does Not Include Compensation For Property Values That Are Enhanced Because Of Revocable Government Action, Or That Result From A "Combination" That The Property Owner Could Not Effect

It is well-established that the government does not have to compensate the owner for property values that are enhanced because of the use to which the government intends to put the property. See *Fuller*, 409 U.S. at 492; *Reynolds*, 397 U.S. at 16; *United States v. Cors*, 337 U.S. 325, 334 (1949); *Miller*, 317 U.S. at 377. *Cors*, for example, involved a government taking during World War II of a steam tug owned by a private individual. The government's demand for steam tugs to be used during the war greatly increased the value of these vessels. See 337 U.S. at 328-29. The owner of the tug argued that just compensation should be measured by the value of the steam tugs after the government announced its intent to institute a wartime ship requisition. *Id.* at 327. The Court rejected this argument, holding that "[i]t is not fair that the government be required to pay the enhanced price which its demand alone has created." *Id.* at 333.

In *Fuller*, a cattle farmer had obtained a permit from the federal government to graze his cattle on neighboring lands owned by the federal government. See 409 U.S. at 488-89. The government later condemned a portion of the farmer's land adjacent to the grazing land. *Id.* at 489. The farmer argued that the grazing permit greatly increased the value of the condemned land and the government should pay for the increased value. *Id.* The Court reaffirmed the principle that the government "need not compensate for value which it could remove," *id.* at 492, and held that

the value of the farmer's property was to be assessed on its own and not in combination with property used by permit from the government. *Id.* at 492-93.

In *United States ex rel. T.V.A. v. Powelson*, 319 U.S. 266 (1943), the federal government condemned 12,000 acres of land in North Carolina on behalf of the Tennessee Valley Authority. The landowner argued that the value of the land should be assessed by reference to its value if used in combination with other lands that he could have acquired, but did not, by power of eminent domain previously granted to him by the State. *Powelson*, 319 U.S. at 274. The Court cited previous cases in which it had denied recovery "for a value dependent upon a combination which [the landowner] could not reasonably expect to effect." *Id.* at 276 (citing *McGovern v. New York*, 229 U.S. 363 (1913)). The fact that the landowner had been given the power of eminent domain—and thus might reasonably have expected to bring about the combination of land parcels that would have increased the value of all—was irrelevant, the Court held, because "just compensation" should not include the enhanced value resulting from a privilege conferred by the State. *Id.* at 276-77.¹⁴

C. IOLTA Programs Do Not Take a Compensable Interest In Property

The analysis in *Cors*, *Fuller* and *Powelson* applies to this case. In the case of IOLTA programs, the fair market value of the owner's property interest is what he or she would have earned in the absence

¹⁴ The Court did not find it significant that the federal government had "taken" the property whereas the State had conferred the privilege artificially enhancing its value. *Powelson*, 319 U.S. at 278-79.

of the program. Absent an IOLTA program, a client entrusting to a lawyer funds that are nominal in amount or to be held for a short term could not expect to earn a return on the funds so entrusted. Nor could the client "effect [a] combination," *Powelson*, 319 U.S. at 276, by pooling funds with others similarly situated, that would make the use value of that client's funds realizable by the client. Absent an IOLTA program created by a State, the use value of such client trust funds would inure solely to the financial institutions holding the funds. It is the government's power to require that such funds be aggregated to a point where the collective use value is realizable as interest paid, and then to require that the interest be used for public purposes rather than inure to the banks, that results in any interest at all being paid on the funds in trust. As in *Cors*, *Fuller*, and *Powelson*, this enhancement created by government action should not be taken into account in determining the fair market value of the property that has been taken.¹⁵

The Court's judgment in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), is not inconsistent with this approach. In that case, having found a constitutionally-protected property interest in the interest generated on an interpleader fund, the Court found that the money to be refunded to the petitioning party was the amount in the fund less

¹⁵ IOLTA funds would have a "use value" in the absence of IOLTA programs, but that use value would be appropriated by banks and other financial institutions that receive deposits without paying interest on them. IOLTA programs transfer the use value of IOLTA funds from banks (which clearly lack any constitutionally-protected property interest) to governments.

charges attributable to maintenance of the account. *See* 449 U.S. at 161. The Court rejected the State of Florida's argument that "having mandated the accrual of interest," the State was "entitled to assume ownership of the interest." *Id.* at 162. In the case of IOLTA programs, the States do more than simply mandate the accrual of the interest. They make the accrual of interest possible by aggregating funds for which a net positive return would otherwise not reasonably be expected. Therefore, unlike the situation in *Webb's*, the government puts the property owner's funds to a use which the owner could not replicate in the absence of the state program.

Contrary to the court of appeals' suggestion (Pet. App. 12a), *Webb's* does not recognize a "rule" for defining property "that is independent of the amount or value of interest at issue." In *Webb's*, the Court had no difficulty in determining that the value of the interest at issue was more than \$100,000, after deduction of a statutory fee. 449 U.S. at 158. Absent the Florida law at issue in *Webb's*, the owner of the funds (which amounted to more than \$1.8 million) clearly could have realized the use value of those funds. Thus, *Webb's* does not stand for the proposition that courts decide whether an asserted property interest is cognizable under the Fifth Amendment without reference to whether the interest has any economic value to the party asserting it.

In sum, only those client funds that would not otherwise earn interest for the client may be deposited into IOLTA accounts. Without the benefit of aggregation of funds provided by the IOLTA program, the individual deposits would have no realizable value to the owners of the funds beyond the principal amounts. Because the interest earned on IOLTA

funds results from the government program, the fair market value to the client is what it would be in the absence of the government program: zero. Client-owners thus have no entitlement under the Fifth Amendment to compensation for interest on IOLTA funds. *See generally* *Marion & Rye Valley Ry.*, 270 U.S. at 282 ("nothing [is] recoverable as just compensation, because nothing of value was taken"); *see also* *Pewee Coal Co.*, 341 U.S. at 121 (Reed, J., concurring); *Nortz*, 294 U.S. at 327-30. An interest that is not compensable under the Fifth Amendment is not a constitutionally protected property interest.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

DAVID B. ISBELL
ROBERT A. LONG, JR.
CAROLINE M. BROWN
COVINGTON & BURLING
P.O. Box 7566
1201 Pennsylvania Ave., N.W.
Washington, D.C. 20044
(202) 662-6000

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RICHARD RUDA *
Chief Counsel
STATE AND LOCAL
LEGAL CENTER
Suite 345
444 North Capitol St., N.W.
Washington, D.C. 20001
(202) 434-4850

* Counsel of Record for the
Amici Curiae